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Politics this week

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The American secretary of state, **Condoleezza Rice**, toured the Middle East to promote George Bush's plan to send more troops to Iraq; she also sounded out the Palestinians and Israelis over the possibility of reviving a peace process, and proposed a three-way meeting soon. As well as Israel and the Palestinian territories, she visited Egypt, Jordan, Saudi Arabia and Kuwait. See article

Israel's top general, Dan Halutz, resigned over the handling of last summer's war in Lebanon. Meanwhile, the justice ministry announced a criminal investigation into corruption allegations against the prime minister, Ehud Olmert, whose government looks increasingly fragile.

Sectarian carnage in **Iraq** persisted. A bomb attack on a university in Baghdad killed at least 70 people, many of them female students, while attacks elsewhere in Baghdad and in the disputed city of Kirkuk killed at least another 100. The government, meanwhile, said it had agreed to a new law to distribute oil revenue fairly among Iraq's people.

Reuters

Tunisia's interior minister said that an armed group that was broken up by security forces in a recent shoot-out were radical Islamists who had infiltrated from **Algeria**. This raised fears that groups linked to al-Qaeda were trying to build a north African front.

On a tour of Latin American countries with anti-American governments, **Iran's** president, Mahmoud Ahmadinejad, said he would put $1 billion into an Iranian-Venezuelan fund to help poor countries throw off the “yoke of American imperialism”. But back home, powerful figures criticised him for his bellicose foreign policy and extravagant economics. See article

The African Union continued its effort to raise an 8,000-strong peacekeeping force for **Somalia** to replace the Ethiopian army which, with American backing, has swept the Islamists from power in the past few weeks. See article

On second thoughts

José Luis Rodríguez Zapatero, **Spain's** socialist prime minister, said he had made a “mistake” in predicting improved relations with ETA, the Basque terrorist group. His prediction had been made one day before ETA broke a ceasefire on December 30th with a bomb at Madrid's airport that killed two people. See article

Breaking a seven-month political stalemate, a centre-right coalition under Mirek Topolanek formed a government in the **Czech Republic**. It relies on two defectors from the opposition for its majority in the deadlocked parliament.

A vote in **Ukraine's** parliament diminished the power of the presidency. The measure was another blow to President Viktor Yushchenko, and a victory for Viktor Yanukovich, the prime minister. Yulia Tymoshenko, the president's former ally, sided with Mr Yanukovich for the vote.

Security was increased in the **Moscow** metro and at transport and infrastructure facilities across Russia following warnings of an impending terrorist attack. The security services said they were acting on a tip-off from foreign colleagues.

Reuters

Nearing the end?

Fidel Castro has had three operations for diverticulitis— an inflamed colon—and is now suffering from peritonitis, and other complications, according to a detailed account in *El País*, a Spanish newspaper. Cuban officials have refused to discuss their president's condition, except to deny American claims that he has cancer.

In the first confession by a senior paramilitary leader in **Colombia** under a controversial peace process, Salvatore Mancuso gave details of the killing of more than 300 people in 87 different militia operations. See article

Evo Morales, **Bolivia's** president, sent the army to patrol the country's third city, Cochabamba, after two people were killed and dozens wounded in clashes between his supporters and those of the local governor, who supports regional autonomy.

Talking shop

Meeting in Cebu, the Philippines, leaders of the **Association of South-East Asian Nations** (ASEAN) agreed to accelerate their move toward a regional free-trade area, and signed an agreement on migrant labour. An accord was also reached with China on liberalising trade in services. See article

China and Russia vetoed a UN Security Council resolution put forward by America condemning the junta in **Myanmar** and demanding political reform. Indonesia, its ASEAN partner, abstained.

The foreign ministers of **India** and **Pakistan** met in Islamabad. There was no breakthrough, but both sides spoke positively of a peace process that had appeared in jeopardy after last July's bombings in Mumbai. See article

Fakhruddin Ahmed, a former World Bank economist and central-bank governor, was appointed the new head of **Bangladesh's** caretaker administration. With the country in a state of emergency enforced by the army, Mr Ahmed promised to arrange credible elections. See article

In important steps towards cementing peace in **Nepal**, Maoist rebels took seats in an interim parliament, and promised to dissolve their parallel government. They also began to register and lock up their weapons.

Senior Afghan and American officials continued to accuse **Pakistan** of harbouring Taliban militants active in Afghanistan. Pakistan denied the charges and mounted air strikes on a militant camp in South Waziristan, a tribal area bordering Afghanistan. See article

The **Philippines** army claimed to have killed Abu Sulaiman, a leading member of the Islamist militant group Abu Sayyaf, in a gun battle. The group has been linked with al-Qaeda.

The new kid on the block

Reuters

Barack Obama took his first formal step towards running for president by forming an exploratory committee. The senator from Illinois, who has held his seat for two years, is considered a front-runner for the Democratic nomination along with a certain senator from New York who is expected to make her intentions known (officially) soon. See article

Jury selection began in the trial of **Lewis "Scooter" Libby**. The former chief of staff for the vice-president, Dick Cheney, is accused of perjury in an investigation into the leaking of a former CIA officer's name to the press. The Plame affair was a headache for George Bush prior to the 2004 election.

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Business this week

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BP's management was sternly criticised in a report from a panel investigating safety at its operations in the United States. The panel, led by James Baker, a former secretary of state, was commissioned by BP (on the recommendation of America's chemical-safety board) after an explosion at its Texan oil refinery in 2005 killed 15 people and injured 170 others. John Browne, BP's chief executive, who last week said he was stepping down in July, vowed that the report's recommendations would be implemented in full. See article

A consortium of **private-equity firms** offered $37.6 billion for **Equity Office Properties**, topping Blackstone's bid for America's largest real-estate investment trust. The target of the biggest-ever leveraged buy-out, Equity Office owns 20m square feet (1.9m square metres) of office space in Manhattan alone, and is attractive because rents in many of America's business districts are predicted to rise.

Loosening the purse strings

General Electric agreed to buy the aerospace business of **Smiths**, a British engineering group, for $4.8 billion, boosting GE's presence in supplying flight management, landing gear and cockpit systems to civilian and military aircraft makers. GE's spending spree looked set to continue with speculation that it was about to buy the diagnostics business of **Abbott Laboratories**.

Airbus reported 790 net orders for aircraft last year, confirming it had slipped behind **Boeing** (which took 1,044 orders) for the first time since 2000. But despite the production misery surrounding its A380 super-jumbo, Airbus managed to deliver more aeroplanes than its rival.

The trial of 19 former senior executives at **Swissair** began in Zurich. The airline, once considered a paragon of Swiss business efficiency and reliability, collapsed in 2001 with debts of SFr17 billion ($10.5 billion). The 19 defendants are accused of neglecting their responsibilities to shareholders when making expansive acquisitions in the 1990s.

The parent company of **American Airlines** reported net income of $231m for 2006, its first profitable year since 2000. The carrier benefited from a surge in travel.

Digging itself out of a hole

Eurotunnel's debt-restructuring plan was approved by a French court (and 33 lawsuits from creditors appealing against the process were thrown out). The operator of the tunnel linking Britain and France has £6.2 billion ($12.2 billion) of debt, which will be cut by half as agreed to by most debt-holders. Shares in Eurotunnel, suspended since last spring, are expected to start trading again next month.

An $8.9 billion offer for **Cablevision Systems** from the company's founding Dolan family seemed doomed after it was turned down by a special committee of the board for not offering fair value. Charles and James Dolan, respectively Cablevision's chairman and chief executive, led the bid.

The share prices of **Intel** and its arch-rival **Advanced Micro Devices** came under pressure after indications that the chipmakers' price war is hurting profits. Intel announced that gross profit margins in 2007 would be lower than expected. AMD said its fourth-quarter earnings (due next week) would show its profit had been squeezed by prices.

Apple surpassed the already giddy forecasts of its quarterly earnings and reported a net profit of $1 billion, a rise of 77% for the quarter ending December 30th compared with a year ago. Some 21m iPod players were shipped in the period, 50% more than last year.

The **music industry's** trade group said that worldwide revenue from tunes legally downloaded from the internet almost doubled in 2006, to $2 billion, accounting for 10% of all music sales. Although 795m songs were transferred to music players, burned to blank discs and the like, that was not enough to cover the loss to recording companies of falling CD sales.

A zesty rise in the price of **oranges** was forecast after a cold snap in California's Central Valley damaged a large part

of the crop. The frigid weather also hurt other produce, including lemons, lettuces and avocados. Around 20% of America's oranges are grown in the Golden State, mainly for eating rather than pulping as orange juice.

Give me liberty, anytime

The annual **"index of economic freedom"** for 157 countries was released. The index measures ten variables, such as the ability to do business, property rights, corruption and labour freedom. The average score (0 equals repressed, 100 equals free) was 60.6%, down slightly from last year but the second-highest since the survey began. North Korea remained rooted at the bottom (several countries, including Iraq, were not ranked).

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Globalisation and the rise of inequality

Rich man, poor man

Jan 18th 2007
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A poisonous mix of inequality and sluggish wages threatens globalisation

James Fryer

Get article background

GLUERS and sawyers from the furniture factories in Galax near the mountains of Virginia lost their jobs last year when American retailers decided they could find a better supplier in China. At the other end of the furniture industry Robert Nardelli lost his job this month when Home Depot decided it could find a better chief executive in his deputy. But any likeness ends there. Mr Nardelli's exit was as extravagantly rewarded as his occupation of the corner office had been. Next to his $210m severance pay, the redundant woodworkers' packages were mean to the point of provocation.

That's the way it goes all over the rich world. Since 2001 the pay of the typical worker in the United States has been stuck, with real wages growing less than half as fast as productivity. By contrast, the executive types gathering for the World Economic Forum in Davos in Switzerland next week have enjoyed a Beckhamesque bonanza. If you look back 20 years, the total pay of the typical top American manager has increased from roughly 40 times the average—the level for four decades—to 110 times the average now.

These are the glory days of global capitalism. The mix of technology and economic integration transforming the world has created unparalleled prosperity. In the past five years the world has seen faster growth than at any time since the early 1970s. In China each person now produces four times as much as in the early 1990s. Having joined the global labour force, hundreds of millions of people in developing countries have won the chance to escape squalor and poverty. Hundreds of millions more stand to join them.

That promises to improve the lot of humanity as a whole incalculably. But in the rich world labour's share of GDP has fallen to historic lows, while profits are soaring. A clamour is abroad that Mr Nardelli and his friends among the top hundredth—or even the top thousandth—of the population are seizing the lion's share of globalisation's gains. Meanwhile everyone else—not just blue-collar factory workers but also the wider office-working middle class—shuffles along, grimly waiting for the next round of cost-cuts. They are not happy.

Fear and clothing

Signs of a backlash abound. Stephen Roach, the chief economist at Morgan Stanley, has counted 27 pieces of anti-China legislation in Congress since early 2005. The German Marshall Fund found last year that, although most people still say they favour trade, more than half of Americans want to protect companies from foreign competition even if that slows growth. In a hint of labour's possible resurgence, the House of Representatives has just voted to raise the federal minimum wage for the first time in a decade. Even Japan is alarmed about inequality, stagnant wages and jobs going to China. Europe has tied itself in knots trying to “manage” trade in Chinese textiles. The Doha round of trade talks is dying.

What is to be done about this poisonous mix? If globalisation depends upon voters who, as workers, no longer think

they gain from it, how long before democracies start to put up barriers to trade? If all the riches go to the summit of society and that summit seems beyond everybody else's reach, are the wealth-creators under threat?

Should you blame China or your computer?

The panic comes in part from a rush to lump all the blame on globalisation. Technology—an even less resistible force—is also destroying white- and blue-collar tasks in a puff of automation and may play a bigger role in explaining rising wage inequality and the sluggish growth of middling wages. The distinctions between technology and globalisation count, if only because people tend to welcome computers but condemn foreigners (whether as competitors or immigrants). That makes technology easier to defend.

For economists, the debate about whether technology or globalisation is responsible for capital's rewards outpacing those of labour is crucial, complicated and unresolved. One school, which blames globalisation, argues that the rocketing profits and sluggish middling wages of the past few years are the long-lasting results of trade, as all those new developing-country workers enter the labour market. This school says that technology helps workers by increasing their productivity and eventually their wages. The opposing school retorts that technology does not increase wages immediately, and some sorts of information technology seem to boost the returns to capital instead (think of how much more a dollar's worth of computing power can do these days). And it questions whether Western incomes will remain flat: recent wage rises in America and pay claims in Europe and Japan may start to reverse the balance back away from capital.

In practice, it is hard to parcel out the blame between technology and globalisation, because the two are so intertwined. Ask IBM, which is hastily shipping bits of its services arm to India; or the call-centre worker who sees off the threat of his job going abroad by settling for only a tiny pay rise. And from a policymaker's point of view, it matters little what is causing the pain: the remedies are broadly the same.

The first rule is to avoid harming the very miracle that generates so much wealth. Take for instance the arguments about high executive pay. Some say this is simply a matter of governance—and forcing company boards to work better. If only it were that simple. High pay is, by and large, the price needed to attract and motivate gifted managers, as our special report argues in this issue. The abuses of companies such as Home Depot obscure how most high pay has been caused not by powerful bosses fixing their own wages, but by the changing job of the chief executive, the growth of large companies and the competitive market for talent. Executive-pay restrictions would not put that horse back in its box, but they would harm companies.

If the winners are difficult to curb without doing damage to your economy, the losers are tough to help. Doling out aid for the victims of trade makes sense in theory; but in practice it is increasingly hard to do (see article). When the jobs going abroad are not whole assembly lines, but bits of departments, how exactly do you pick out the person who has lost his job to globalisation from the millions of people changing jobs for other reasons? And, hardhearted though it may sound, most of the gains from trade and technology alike come from the way they redeploy investment and labour to activities that create more wealth. That, like all change, can be painful; but it is what makes a country richer. A policy locking people into jobs that could be better done elsewhere is self-defeating.

The same goes for protectionism—especially now that the victims of globalisation are so scattered throughout the rich world, not camped in embattled industries. Trade has always created losers and it has always been in their narrow interest to seek protection (even if it hurts everyone else). But if many workers across many different industries were to demand protection at once, the selfish appeal of such a shield would fade.

Because hardship from globalisation is so difficult to distinguish from hardship in general, it would be open season to put up trade barriers in industry after industry. Widespread protection would surely meet with retaliation from abroad. Even if people gained as workers they would lose as consumers, investors and future pensioners. Moreover, the protection of jobs and pay would be short-term, because it would gradually lead to companies losing competitiveness as rivals in India and China innovated (see article). Paradoxically, therefore, the greater the number of people threatened by globalisation, the less each of them is likely to gain from getting their governments to stand in its way.

The limits of redistribution

If protectionism will not help the losers, what about using the tax system? Some argue that redistributing more cash from the Nardellis to the Galaxians would not just make society less unequal; it would also buy middle-class support for globalisation. In fact the two arguments should be kept separate.

This newspaper has long argued that a mobile society is better than an equal one: disparities are tolerable if combined with meritocracy and general economic advance. For decades America has shown how dynamic economies are better than equality-driven ones at generating overall prosperity. That still leaves plenty of room to debate how progressive to make taxation (some of George Bush's tax cuts were needlessly regressive), or how lavish to make public services (American welfare is hardly generous). But a society would want compelling evidence that the social

contract had been torn up before flexing the tax system to offset what may turn out to be only temporary fluctuations in relative incomes. And it makes little sense for free-traders to use taxes to buy off people from voting for protectionism, when doing so would in any case be against their interests.

Active, not reactive

Instead, the way to ease globalisation is the same as the way to ease other sorts of economic change, including the impact of technology. The aim is to help people to move jobs as comparative advantage shifts rapidly from one activity to the next. That means less friction in labour markets and a regulatory system that helps investment. It means an education system that equips people with general skills that make them mobile. It means detaching health care and pensions from employment, so that every time you move your job, you are not risking an awful lot else besides. And for those who lose their jobs—from whatever cause—it means beefing up assistance: generous training and active policies to help them find work.

None of that comes cheap—and much of it takes years to work. But an economy that gains from globalisation can more easily find the money to pay for it all. The businesspeople and politicians gathering on their Swiss Alp next week should certainly spend more time worrying about the citizens of Galax; but they also need to be far more courageous about defending a process that can do so much good even if its impact can sometimes appear so cruel.

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The Democrats

A good start

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A disciplined Congress and an interesting candidate, but the hard stuff comes now

Reuters

THIS is springtime for America's Democrats. They have made a confident and impressive start in Congress, which they took over on January 4th after 12 years in the minority. George Bush is reeling from the catastrophe unfolding in Iraq, his latest scheme for correcting his mistakes condemned by almost everyone. And one of the most refreshing hopefuls for many years, Barack Obama, on January 16th in effect announced his intention to become America's first black president. When Hillary Clinton weighs in, as she is sure to do in a matter of days, the Democrats will have two ground-breaking candidates for voters to choose from.

Mr Obama (see article), though short on experience, is long on charisma and unbeatable for oratorical flair; Mrs Clinton rather the reverse. But the fortunes of whichever of them emerges on top will depend at least in part on voters' perceptions of the Democrats in general. And for that the behaviour of the new majorities in Congress will be crucial.

As *The Economist* went to press, America's new House of Representatives was preparing to vote on the last of the six pledges its first female speaker had campaigned on, in less than half the promised 100 hours. Nancy Pelosi's Democrats have passed bills to raise the minimum wage, enact all the recommendations of the 9/11 report on security, extend federal funding to stem-cell research, bring down the cost of prescription drugs for the elderly and cut the interest rate on student loans, with a vote to end subsidies to big oil companies under debate. All these need to pass through the Senate, where the Democrats have only a 51-49 majority, and could then be vetoed by Mr Bush. But the House bills have all won backing from unexpectedly high numbers of Republican rebels, making Senate passage much more likely and a presidential veto much more embarrassing. Ms Pelosi seems to have adroitly captured the centre ground of American politics, and the smarter sort of Republican, with an eye to re-election in 2008, is happy to be seen in her company.

Equally significant is what Ms Pelosi has not done. Despite the rumours, there has been no flurry of subpoenas from Capitol Hill. Hearings there will doubtless be on everything from Iraq to the links between big oil and the administration. But the Democrats have avoided an ugly immediate show of partisan strength, which should please a public tired of political bickering. True, they are pressing for a non-binding vote against Mr Bush's unpopular new plan for a “surge” into Iraq. This newspaper disagrees with them on that, but even here the grandstanding is limited. A non-binding vote is just that: the Democrats are too sensible to threaten anything that could backfire on them, such as cutting off funds.

Can Ms Pelosi and her gang of moderates continue to hold the centre ground? So far, they have done the easy stuff—five relatively uncontroversial bills (not including stem cells) plus a widely welcomed reform of the House's own ethics rules that neither the Senate nor the president can monkey with. There are tougher times ahead. The new crop of Democrats includes a good number of protectionists who would like nothing better than to pick fights with Mr Bush over China or NAFTA. Mr Bush has cannily endorsed the Democrats' call for a balanced budget by 2012, which puts them in the awkward position of having to vote to raise taxes or cut spending, or both.

Left, right and Nancy's centre

If Ms Pelosi can restrain her left wing, the Democrat-held centre ground will be an excellent position from which Mr Obama and Mrs Clinton can fight. None of the plausible Republican candidates can occupy it so easily. Some, like Senator John McCain or Rudy Giuliani, an ex-mayor of New York, are out of kilter with the majority of Americans over Iraq, besides having difficulties with their own party base on “values” matters. Others, like ex-governors Mitt Romney and Mike Huckabee, are in hock to the conservative right. Just now, the Democrats look distinctly well-positioned.

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Big Oil

Browne out

Jan 18th 2007
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An oilman's career encapsulates both the industry's past successes and its new worries

AFP

IT IS hard to summon much sympathy for the bosses of big oil firms. Their companies are among the most profitable on earth, and many of them have egos to match. They are at their richest and most powerful when oil prices rise, emptying the pockets of humbler folk and slowing whole economies. Despite all this, however, there is something poignant in the imminent retirement of John Browne, BP's boss since 1995.

Lord Browne has set the tone for the oil industry for much of the past decade. He was the first oil boss to champion, or at least not try to squash, greenery. There was a degree of public relations in this—BP is certainly not “Beyond Petroleum”, as its slogan claims, although it does have investments in alternative energy. But merely by breaking ranks on the subject, he helped bully his peers into a debate about global warming.

Lord Browne also created the industry's first “super-major” by merging BP with Amoco in 1998. The deal vaulted BP into the top ranks, and forced rival oil firms, including Exxon, Total and Chevron, into mergers of their own to keep pace. In 2003 he persuaded Vladimir Putin, Russia's president, that BP should buy half of a Russian oil firm—a feat no other foreigner has matched. Throughout this expansion, he kept costs down and profits up, to shareholders' delight. Since he took charge, BP's share price has more than doubled, its market capitalisation has risen fourfold and its earnings per share fivefold.

But over the past two years BP's star has dimmed. In March 2005 a fire at an American refinery killed 15 people and injured 170 more. Since then, BP has suffered corrosion and spills on its pipelines in Alaska, delays in developing new oilfields and two investigations of its trading arm for price-rigging. American officials and politicians have pilloried the firm for these failings. Last week, just days before the publication of the latest critical report, when Lord Browne said that he was bringing his retirement forward by 17 months to July, observers assumed that the announcement was intended to draw a line under BP's recent woes, and give his successor a fresh start.

With the benefit of hindsight, critics now claim to see a connection between BP's setbacks and Lord Browne's management style. Several reports prompted by the refinery fire—including one released this week by a panel headed by James Baker, a grand old oilman of American politics—have found that budgets and staff were stretched thin (see article). Tony Hayward, Lord Browne's successor, recently conceded that BP's “more-for-less” mantra could be taken only so far.

Whether BP's managers were negligent or simply unlucky will be difficult to judge—although lawyers will doubtless devote lots of time and money to the question. But BP is hardly the only firm that has ruthlessly cut costs. If there is a clear lesson to be learned from BP's troubles, it is that the strategies that have propelled the oil industry for the past decade, and that Lord Browne epitomised, are reaching their natural limits.

Big-oil nostalgia

BP will clearly have trouble cutting costs much further. In fact, a shortage of skilled workers and equipment is already pushing its bills up. Its biggest fields are maturing, as are those of other Western oil firms, yet access to new reserves is getting harder. Most of the world's most promising acreage lies in the Middle East, where nationalistic regimes restrict foreigners' access. Even countries like Russia, until recently the industry's great hope, are rolling up the welcome mat.

Nowadays, “Big Oil” reigns supreme in only a relatively small niche: the most technologically challenging and expensive projects, such as drilling in deep water, or turning tarry sand into something more useful. Unfortunately, these investments bring higher risks and lower rewards. Such trends should be worrying all oil bosses.

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About sponsorship

Video games

Don't shoot the messenger

Jan 18th 2007
From The Economist print edition

Films are not banned to keep them away from children. The same should apply to video games

Alamy

THEY poison the mind and corrupt the morals of the young, who waste their time sitting on sofas immersed in dangerous fantasy worlds. That, at least, was the charge levelled against novels during the 18th century by critics worried about the impact of a new medium on young people. Today the idea that novels can harm people sounds daft. And that is surely how history will judge modern criticism of video games, which are accused of turning young people into violent criminals. This week European justice ministers met to discuss how best to restrict the sale of violent games to children. Some countries, such as Germany, believe the answer is to ban some games altogether. That is going too far.

Grand Theft Coach and Horses

Criticism of games is merely the latest example of a tendency to demonise new and unfamiliar forms of entertainment. In 1816 waltzing was condemned as a “fatal contagion” that encouraged promiscuity; in 1910 films were denounced as “an evil pure and simple, destructive of social interchange”; in the 1950s rock 'n' roll music was said to turn young people into “devil worshippers” and comic books were accused of turning children into drug addicts and criminals. In each case the pattern is the same: young people adopt a new form of entertainment, older people are spooked by its unfamiliarity and condemn it, but eventually the young grow up and the new medium becomes accepted—at which point another example appears and the cycle begins again.

The opposition to video games is founded on the mistaken belief that most gamers are children. In fact, two-thirds of gamers are over 18 and the average gamer is around 30. But the assumption that gamers are mostly children leads to a double standard. Violent films are permitted (“Apocalypto”, anyone?) and the notion that some films are unsuitable for children is generally understood. Yet different rules are applied to games.

Aren't games different because they are interactive? It is true that video games can make people feel excited or aggressive, but so do many sports. There is no evidence that video-gaming causes long-term aggression; violent crime in America has fallen as games have become popular. Violent criminals do sometimes turn out to have been gamers. But since so many people play video games (half of all Americans, for a start) it would be strange if some criminals did not.

Games ought to be age-rated, just as films are, and retailers should not sell adult-rated games to children any more than they should sell them adult-rated films. Ratings schemes are already in place, and in some countries restrictions on the sale of adult-rated games to minors have the force of law. But most games for children are bought by parents. Rather than banning some games outright, the best way to keep grown-up games away from children is to educate non-gaming parents that, as with films, not all games are suitable for children.

Oddly enough, Hillary Clinton, one of the politicians who has led the criticism of the gaming industry in America, has recently come round to this view. (Perhaps someone gave her a Nintendo Wii.) Last month she emphasised the need

for parents to pay more attention to game ratings and called on the industry, retailers and parents to work together. But this week some European politicians seemed to be moving in the other direction: the Netherlands may follow Germany, for example, in banning some games outright. Not all adults wish to play violent games, just as not all of them enjoy violent movies. But they should be free to do so if they wish.

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China and the press

One less brick in the wall

Jan 18th 2007
From The Economist print edition

A rare piece of good news about news-gathering in China

AP

IN A quaint tradition the Ministry of Foreign Affairs in Beijing used to mark the end of foreign correspondents' stints in China with a gift. There was probably no irony intended in the choice of memento: a plate emblazoned with a picture of the Great Wall. China's most famous architectural deterrent to foreign interaction was a fitting symbol for those reporting on the country. They were hemmed in by rules banning much that, elsewhere, would seem routine. Not any more. On January 1st looser rules came into force. It is too early to cheer; but this may be an important reform to a woefully repressive system.

Before, foreign journalists had to obtain permission from the relevant local government for any reporting outside the capital. Journalists are an unruly lot and of late most have simply ignored the rule. The central government has turned a blind eye. Not, however, local governments, which would routinely expel foreign journalists on their patch, sometimes after detaining them and roughing them up first.

The new rules, however, in force until after next year's Beijing Olympics, allow foreign reporters to go more or less where they please. The implications are wide-ranging: for the first time, the foreign press can legally cover breaking news outside Beijing, as it unfolds. To take just three run-of-the-mill events that have until now usually been out of range, these might include a protest against an official land-grab, a disastrous explosion in a coalmine or a chemical spill. The scandalous cover-ups that have blighted China's response to SARS and avian influenza should become harder. All this, of course, depends on whether the new rules are respected.

In an early test of this, our Beijing correspondent has been investigating one outrageous cover-up: over the fate of the tens of thousands infected with HIV/AIDS during a botched blood-collection drive (see article) in Henan province. Cynicism about the government's intentions appeared justified. Soon after arriving in an “AIDS village”, local officials turned up and told him to go away. His phone call to the foreign ministry in Beijing, however, led the local authorities to co-operate.

A sporting chance

A single swallow does not make a journalistic summer. A spate of negative stories and the government may backtrack. It is motivated not by a new-found love of freedom but by practicalities: how to manage 20,000 reporters expected for the 2008 Olympics; how to stop nasty stories about press restrictions; and, perhaps, how to rein in errant local governments. More likely than a repeal of the new rules is that local governments will shift from the arbitrary enforcement of the old ones to the use of deniable thuggery to frighten reporters and their sources. Just this month a Chinese reporter investigating an unlicensed coalmine was beaten to death. Already, at least one of our interviewees in Henan is feeling the heat.

In other ways, there is no let-up in Chinese censorship of all media, including the internet. Journalists and bloggers risk losing their jobs and freedom. This week it was reported that the Communist Party had actually tightened its grip—“pre-censoring” the local press by demanding it seek permission to cover sensitive events. But the new freedoms allowed foreign reporters are at least a step forward, and evidence to support those who argued that the Olympics would force China into greater openness. Those, like this newspaper, who argued that the games would be taken as a badge of global respectability but would have next to no lasting impact on China's viciously repressive politics would be delighted to be proved wrong.

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Israel and America

Spurning an olive branch

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From The Economist print edition

America should not tell Israel to reject an overture from Syria

AP

YOU are 6m Jews living in a sea of hostile Muslims. Fortunately you happen to be a good friend of the world's only superpower. Israel's interest is accordingly to stick closely to the policies of the United States. It stands to reason, doesn't it?

Perhaps not. America is constantly accused, and often with justice, of being uncritically supportive of Israel. What is less often noticed is that Israel is too often uncritically supportive of America. And although this may at first look as if it makes strategic sense for the Jewish state, it doesn't always.

Here is a case in point. Bashar Assad, Syria's dictator, appears to have been signalling lately that he is willing to hold peace talks with Israel. It seems that he is not even insisting, as his father Hafez used to, on Israel promising before any talks to give back the whole of the Golan Heights. Furthermore, according to revelations this week in *Haaretz*, Israel's liberal daily, some people from each side have already engaged in several years of secret, unofficial "track-two" diplomacy, going so far as to have produced a draft peace treaty (see article).

Sorry, but Uncle Sam says no

Plainly, Ehud Olmert, Israel's prime minister, should grab any opportunity to talk. For many decades most of Israel's enemies denied its right to exist, let alone to enjoy normal neighbourly relations. The Palestinians' Hamas movement and Iran still take that line. So even if talks with Syria did not lead immediately to peace—and they probably wouldn't unless Israel gave up the Golan—they would at least knock a mighty hole in the idea, once again spreading in the wider Muslim world, that the very existence of Israel is illegitimate and not to be accepted in any circumstances. And yet Mr Olmert has so far said no to talks. In saying no, moreover, he gave Israelis a singular reason. He said that by talking to the president of Syria Israel would upset the president of the United States.

Right now George Bush has reasons to be unfriendly to Mr Assad. Syria helps the insurgents in Iraq, is trying to topple the government of Lebanon and is desperate to evade whatever responsibility it may have had for killing Lebanon's former prime minister, Rafiq Hariri, in 2005. To the degree that peace talks with Israel would ease Mr Assad's isolation—and ingratiating himself with the West may well be the cynical extent of Mr Assad's intentions—they might indeed complicate America's present strategic calculations in the Middle East.

If you are a superpower, however, your strategy has a habit of changing, along with conditions, regimes and fashion. America has the luxury of being able to reassess its interests, drop old friends and find new ones, promote autocracy one day and emphasise democracy the next. Sometimes its attention swivels right away from the Middle East. Israel, on the other hand, has a permanent and perhaps existential interest in finding a way to get along with its neighbours. It really cannot afford to pass up any opportunity, however cynically motivated, to break the encircling wall of enmity.

If Mr Bush continues to instruct Israel to rebuff Mr Assad's overtures, Mr Olmert will no doubt obey orders. Strong Israeli prime ministers have in the past occasionally refused to take American instruction, but Mr Olmert was never strong and has been further weakened by his inept handling of last summer's war in Lebanon. He may, moreover, have his own cynical reasons for refusing a Syrian olive branch—such as an unwillingness to pay for peace by giving up the Golan, or to make his domestic problems worse by broaching the possibility.

If that is his reasoning, it is short-sighted. A land-for-peace deal in the West Bank and Golan remains Israel's best hope of security. It should be tireless in its quest for peace, even when its great ally is preoccupied elsewhere. In the long run, after all, resolving this conflict is in America's interest, too.

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About sponsorship

On family income, happiness, bribery, sperm banks, economic indicators, country music, Russia's airports, Israel, Iraq, energy

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From Economist.com

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Social insecurity

SIR – In appraising my book, "The Great Risk Shift", you argue that family-income uncertainty and instability are not serious concerns (Economics focus, January 6th). While Americans can borrow to deal with financial setbacks, borrowing is perilous. Home foreclosures are up sharply. Bankruptcy rates have rocketed, and not just because filing is cheaper. The average person who filed for bankruptcy in 2001 was worse off than the average bankrupt person 20 years earlier.

America has a unique system of employment-based security that is rapidly eroding. At the last count, nearly 47m residents in the United States lacked health insurance and involuntary job losses are more frequent and more devastating than at any point since the deep downturn of the early 1980s. Meanwhile, employers are abandoning traditional guaranteed pensions in favour of individual account plans—such as 401(k) accounts—that place all of the risks of planning retirement on workers. No wonder many middle-class families are anxious and America's leaders are scrambling to respond.

Jacob Hacker
Professor of political science
Yale University
New Haven, Connecticut

Humbug

SIR – Regarding your article on happiness, economists should never have been smitten with the epithet of "dismal" given to their field of study ("Economics discovers its feelings", December 23rd). But nor should they have become embroiled in debating what constitutes happiness and how it can be measured. The subject is more appropriately the purview of philosophers, psychologists and sociologists. The aim of economists is to find the best ways to engender wealth so that more people can choose for themselves the optimum use of their time. That may be more time in the garden or working longer hours. The choice, and the reasons behind that choice, are a matter of individual preference.

Kean Seager
Bristol

SIR – My research shows that countries with a higher economic and social quality of life have a higher suicide-rate. It may be that, as capitalism makes us wealthier and we can buy what we desire, we can no longer blame an external situation for our misery and are forced to realise that our unhappiness has its source in our own minds.

David Lester
Blackwood, New Jersey

SIR – I hope your readers will not be put off by your implication that a colonoscopy causes "discomfort" and "pain". I had the procedure and I wasn't even aware of what was going on until a nurse told me. I urge people to get the examination—my poor old stepdad died of intestinal cancer.

John Lockwood
Washington, DC

Not-so-hard graft

SIR – Bribery also has a long tradition in America, no more so than in Jersey City ("How to grease a palm", December 23rd). From 1917-47 the city was ruled by the town's legendary mayor, Frank "I Am The Law" Hague.

During his time the kickback that city workers had to return to City Hall, known as “rice pudding”, was 3% of their salaries.

An enduring symbol of the Hague era was his famous desk. When he required a “contribution”, Hague would push a drawer in the centre of the desk and a corresponding drawer would open out in front of the donor sitting opposite. An envelope with the cash would be placed in the drawer, which the mayor would pull back to his side. It is not known if the desk is still in use today.

Michael Heydenburg
Jersey City, New Jersey

Size matters

SIR – While Denmark's Cryos is a successful sperm bank worthy of recognition it is not “the world's largest supplier of sperm” (“Buying babies, bit by bit”, December 23rd). California Cryobank is internationally recognised as the world's biggest sperm bank. With 250-300 donors available at any one time and distributing many times the vial volume of Cryos, we have been the pre-eminent leader in the sperm-banking industry since 1977.

Scott Brown
California Cryobank
Los Angeles

Statistical fallacy

SIR – I am disappointed that you have shrunk the economic indicators and placed them on your website (Economic and financial indicators, January 6th). These numbers are personal, like my golf score, or the horses I back. I know they carry none of your high falutin' opinions, but they portray the ebb and flow of economic life and are a unique record of the economic facts. Must I now have to tediously print off a copy from your website to study on my next flight? And what about the arguments I have with friends and colleagues? How else can I win without being able to slap down *The Economist*'s indicators on the table?

John Kimber
Sydney

Always on my mind

SIR – An article that is written as a paean to contemporary country music jangles one almost as much as having to endure the stuff every day in just about every shop, garage and (yes) bank that one is forced to frequent (“Middle America's soul”, December 23rd). Not to mention being forced to listen to it while placed on hold during a phone call. Subtle as a sledgehammer, these maudlin musings set to tunes leave no musical or lyrical clichés untouched or any irony unexplained in their appeal to what Larry the Cable Guy, a redneck comic, calls country music's “patriotic fan base”. Forty years or so ago the musical “British invasion” changed rock 'n roll for the better. Would that something similar could happen today and make country music listenable.

J. Edari
Allenford, Canada

SIR – Perhaps you could explain how, notwithstanding a combination of conservative values and old-time religion, the “too sensible” and “God-fearing, rural-thinking folk” of states such as Arkansas, Kentucky and Tennessee have some of the highest rates of teenage pregnancy, road death and divorce in America?

Robert King
Brookfield, Australia

The Russian jet-set

SIR – I read your article on Russia's airports while sitting in a grotty bar at Moscow's Sheremetyevo airport (“Kama Sutra and feral cats”, December 23rd). I had missed my connecting flight and myself and other passengers, having no Russian visas, were escorted by two KGB-looking gorillas to a side exit and driven to a third-rate hotel to spend the night. I was not allowed to leave the room, which I shared with a huge, snoring Lithuanian, for 15 hours. Only the next day, was I “freed” and delivered back to the 1980s spectacle that is Terminal 2 of the airport. What amazed me about the ordeal is that none of the staff at the airport or the hotel expressed even the briefest of smiles. For those who think the Soviet empire died years ago, I can attest it is alive and well, and flourishing at Sheremetyevo airport.

John Ordovas
Madrid

Existing problems

SIR - Recognising “Israel’s right to exist” is quite different from recognising that “Israel exists” (“A recognition problem”, January 12th, Economist.com). It is silly to insist that Hamas says it believes that Jews were right to move to Palestine and form a Jewish state. That is like asking aboriginal activists in Canada to acknowledge that Britain had a right to colonise their land. It would make more sense to settle on recognition that “the Israeli people have a right to exist in peace and security. We will refrain from using force against them as long as they stay inside mutually agreed borders.”

Phil Northcott
Coquitlam, Canada

SIR - You state without any qualification that Israel’s position “is that it accepts the right of the Palestinians to a state in the West Bank and Gaza, but says that the final border should be set by negotiation”. You fail to mention that the Palestinians have been offering such agreement since 1988 and this was endorsed by the Saudi Peace Plan in 2002, approved by all Arab states. All that has been required to obtain Palestinian agreement was Israeli compliance with international law. Meanwhile, of its own volition, Israel has illegally set up over 460,000 settlers on Palestinian land.

Christopher Leadbeater
Ashford, Kent

Surging

SIR – You ought to point out that the American Enterprise Institute is a neo-conservative, rather than a conservative, think-tank, and is intimately associated with the Israel lobby (“Less a surge than a squirt”, January 9th, Economist.com). The lack of foreign policy success for the Bush administration is a sign of the president’s utter lack of competence, as well as the pernicious influence of lobby groups such as the American Israel Public Affairs Committee.

Fernando Leza
Caracas

Which way to turn?

SIR - You say that an assertive Russia will flex its energy muscles this year (“Power politics”, December 29th, Economist.com). I am surprised that you make no mention of Bulgaria's relationship with Russia. The Bulgarian government announced in November that the prolonged process for the tender of the Belene nuclear power plant has been awarded to Russia’s Atomstroyexport. Not long after it was announced that the government had signed a 30-year agreement with Russia over gas imports. Bulgaria gets 98% of its gas from Russia. Rumen Ovcharov, Bulgaria’s economy and energy minister has even talked about “mutual dependence” with Russia in recent months. Bulgaria will become even more intertwined with Russia despite its recent accession to the European Union. How might this affect Bulgaria’s relationship (and reputation) as a new member of the Union?

Julia Terlinchamp
Sofia

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Trade's victims

In the shadow of prosperity

Jan 18th 2007 | GALAX, VIRGINIA
From The Economist print edition

Hard truths about helping the losers from globalisation

AFP

NESTLED among the wooded Blue Ridge mountains in Virginia's far south-west, Galax is a town of bluegrass music, barbecue and hardscrabble living. It is home to an annual fiddlers' convention and, less happily, a huddle of textile and furniture factories. Over the past few years, globalisation has hit hard.

Unable to compete with Mexican and then Chinese competition, the town's old industries have withered, taking thousands of jobs with them. Last year brought the biggest single blow. Three big factories closed their doors within months. More than 1,000 people, around one-sixth of the town's workforce, lost their jobs.

Galax then acquired an “Economic Crisis Strike Force” for displaced workers, sent in by Virginia's governor, Tim Kaine. Housed behind a liquor store in an old strip mall, the Strike Force helps people apply for Trade Adjustment Assistance (TAA), the government support America offers to those deemed to have lost their jobs to global competition. TAA includes up to two years of unemployment benefits while retraining, temporary subsidies to help pay medical insurance and, for those over 50, a short-term top-up to any lower-paying new job. The centre also co-ordinates more basic help, from child care to food banks run by private charities.

Thousands of people have walked through its doors in the past nine months, many several times. Around one-third of those laid off last year are being retrained. Many others have found new jobs. At 6%, Galax's unemployment rate is twice Virginia's average, but no higher than it was a year ago.

For some, particularly those in their 50s, the future looks bleak. At 59, Paul Rotan sees little chance of finding another job with health insurance, but he is still six years away from qualifying for Medicare, the government health plan for the old. He is terrified of what will happen in June when the temporary public subsidies for his health insurance end.

But other, mainly younger, workers are already better off. After 19 years in a textile factory, Bobby Edwards has retrained as a radiologist. Brian Deaton has set up a thriving picture-framing business and has started selling gourmet coffee. Few of these people are enthusiastic about globalisation. “No one trusts China around here,” is a common refrain. But government help has cushioned the shock. “I'd be lost if they weren't here,” says Mr Rotan, nodding towards the centre's staff.

In the neat world of economics text-books the downside of globalisation looks much like Galax. Low-skilled workers in a rich country, such as America, suffer when trade expands with a poorer country with plenty of much cheaper low-skilled workers, such as China.

If labour markets are efficient in the rich country the displaced workers should find new jobs, but their wages will probably fall. Although the country overall gains handsomely, these people are often worse off. Hence the case for redistributing some of trade's gains and compensating the low-skilled losers. Traditionally, trade-displaced workers have also tended to be older and less educated than typical workers, and to have worked in only one industry. They

take longer than average to find another job and, when they find one, are more likely to see their wages fall.

In America, where labour markets are flexible, the impact is felt on wages more than employment. In Europe fewer trade-displaced workers find new jobs quickly, but those who do take less of a pay cut. One study suggests that, during the 1980s-90s, 65% of manufacturing workers in America who lost their jobs to freer trade were employed two years later, but most took a pay cut. A quarter suffered pay losses of more than 30%. In Europe during the 1990s, in contrast, less than 60% of workers in the same situation had found a new job, but only 7% saw their pay fall more than 30%.

How much to spend?

Nonetheless, help for displaced workers has always been modest compared with the gains from trade. In America, where the social safety net is thinner than in other rich countries, those officially deemed hurt by trade are singled out. Their unemployment assistance lasts four times longer than ordinary workers', and they get more retraining. The United States spends around $1 billion a year on helping trade-displaced workers. But the economy overall, by one estimate, gains $1 trillion a year from freer trade.

In Europe overall public safety nets are far more generous, although in many countries they are being scaled back. European governments also spend much more money than America's on training and other "active" help for all workers. In this more comfortable environment, globalisation's losers have never been singled out.

That may be changing. Public scepticism about trade is rising in both rich countries and poor. A host of big economic shifts, such as rising income inequality, are blamed on global integration. The Doha round of trade talks has long been stalled. America's elections last November brought in a clutch of lawmakers deeply opposed to freer trade. To control this backlash, globalisation's champions are keen to appear more sensitive to the losers.

Already, some shifts are evident. One of the first bills introduced in the Democrat-controlled Senate is a big expansion of TAA, covering not merely manufacturing workers but also service workers whose jobs have been "offshored", and offering help not just to individual factories, but to whole industries.

Introduced by President Kennedy in 1962 to shore up support for tariff cuts, TAA has long been used to buy congressional support for trade deals. It was expanded as part of the North American Free Trade Agreement in 1993 and again in 2002 when George Bush asked Congress for special negotiating authority to pursue trade deals. The fate of the current bill is uncertain, but the Democrats have stressed that their support for future trade agreements depends on more help for workers who lose out.

In Europe the political pressure is similar. As Italy's shoemakers protest about Chinese competition and Germany's car-workers worry about "offshoring" to cheaper eastern Europe, the European Union has recently created a €500m ($650m) Globalisation Adjustment Fund to offer job counselling, training and other help when more than 1,000 people in a firm or industry lose their jobs because of "structural changes in world trade patterns".

But cause and effect may not be so obvious. People filter in and out of employment in huge numbers all the time. In America around 20m jobs, or about one in seven, are lost involuntarily every year. Only a small fraction of those, some 2m-3m a year or 2% of all jobs, are permanent "displacements", where workers have little or no prospect of returning to their old industry. The displacement rates for Europe are broadly similar. And only a small share of these permanent job losses can be directly attributed to globalisation, rather than, say, to technological change.

One study by Lori Kletzer of the University of California, Santa Cruz found that only 14% of displaced manufacturing workers are in industries facing intense international competition. To judge by the number of people receiving TAA, the figure is even lower: fewer than 120,000 workers were deemed eligible for it in 2005. In the much bigger services sector, the share is lower still. For all the hoopla about offshoring, the best estimates suggest that only about 1m American service-sector jobs have actually moved overseas. In short, trade's role in job losses is much smaller than the public angst suggests.

Most economists have long held that technology, rather than globalisation, is the main cause of the rising gap between the pay of the high- and low-skilled. But some argue that the distinctions between trade and technology are increasingly irrelevant. Progress in information and communication technology means that traditional trade models, and their predictions of winners and losers by skill level, are becoming outdated (see article).

In the 21st century competition between firms and industries, such as Galax's furniture factories and their Chinese rivals, is becoming less important than competition between individual tasks within firms in different countries. Whether he is employed in a furniture company or a hospital, the American data-processor will be competing against someone from Bangalore. Rather than affecting entire industries, or whole factories, global competition will affect individual jobs—skilled as much as unskilled.

Such a shift helps explain the popular nervousness about globalisation. Many more workers are worried that their jobs will be at risk. That, in turn, increases the political appeal of assisting trade's losers. But it also makes those losers even harder to identify. And it undermines at least one reason for offering them special help. When trade-displaced workers were older, less educated and hence less easily re-employable than others, helping to retrain them improved the economy's efficiency. But as potential job losses from trade shift up the skill ladder and across industries, those displaced by trade will look much like the rest of the workforce.

An alluring Danish model

As a result, it may be better to focus on policies which improve job prospects for all workers. In Europe, Denmark has led the way. The Danish system of “flexicurity” appears to offer the best of both worlds: dynamic labour markets and low unemployment coupled with generous support for those who lose their jobs.

Denmark has a long history of weak job protection. Employers hire and dismiss people at will. Around a quarter of the workforce is unemployed at some point in any year. But the jobless enjoy generous welfare benefits while they look for work, around 80% of their previous wage on average. To ensure this does not deter people from finding new jobs, the Danes oblige the unemployed to be trained and to look diligently for work.

The European Union is urging its members to follow the “flexicurity” model. Democratic wonks in America enthuse about it too. But Denmark's approach has evolved over decades and cannot easily be copied. Besides, it is extremely expensive. Although Denmark has an unemployment rate of under 5%, it spends more than 5% of GDP on the unemployed, including almost 2% of GDP on its “active” training and job-search programmes. It pays for it with one of the highest tax rates on labour income in the world—one many other European countries, with much higher unemployment rates, could not afford.

For America, which currently spends a mere 0.16% of GDP on such “active” labour-market policies, the idea of Danish-style “flexicurity” is more a slogan than a serious suggestion. Academics agree that employers are far better at training workers than the state. Few politicians in either party support a dramatic expansion of government training programmes.

An alternative approach is to give displaced workers a subsidy if they are forced into a lower-paying job. Such “wage insurance” already exists in a modest form on both sides of the Atlantic. Since 2003 Germany has a scheme where the government makes up 50% of the wages lost by people over 50 who are forced into a lower-paying job. France has a similar scheme with no age qualifications, but limits the subsidy to two years. Since 2002 America's TAA has offered wage insurance to any trade-displaced worker over 50: the government pays half the difference between the old and new wage for two years, up to a maximum of $10,000.

Getting other things right

These experiments are too new to evaluate. But in theory wage insurance is appealing. It helps soothe workers' fears that they will suddenly lose income, but also keeps labour markets flexible by encouraging people to find a new job quickly. Many on America's centre-left see it as the key to maintaining political support for trade.

The proposed expansion of TAA would make any trade-displaced worker over 40 eligible for wage insurance. And more ideas are floating around Washington's think-tanks. One would restructure America's system of unemployment insurance so that the government focused less on smoothing the earnings of the temporarily unemployed and more on helping those who face a longer-term loss of wages. Another would simply expand the type of insurance in today's TAA to displaced workers. The cost, according to Howard Rosen of the Peterson Institute for International Economics, would be $4 billion a year: still far less than the gains from trade.

As public fears of globalisation rise, so will the political appeal of these schemes. But they will have less impact than getting other, more basic, policies right. Globalisation underscores the need for a flexible, dynamic labour market and a well-educated, adaptable workforce. And a worker whose health care is not tied to his job will be less worried about trade than one for whom job loss also spells the loss of medical insurance. The tasks of freeing up labour markets (in Europe), reforming health care (in America) and improving education (everywhere) are far more important than any amount of experimentation with wage insurance or retraining schemes. If politicians really want to respond to the worries caused by globalisation, those are still the best places to start.

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Cotton suicides

The great unravelling

Jan 18th 2007 | GENEVA AND WARDHA
From The Economist print edition

Is globalisation killing India's cotton farmers?

Get article background

RAW cotton from the fields outside Wardha rolls slowly into town, roped to the back of bullock carts. The animals' horns are painted as brightly as the trucks that rattle past them. Their cargo is off-loaded in the forecourt of a ginning plant, where it collects in steep white mounds that look much like the snowscape of a fancy Swiss ski-resort.

Only one in 12 of India's farmers has ever heard of the World Trade Organisation (WTO). The cotton farmers of Vidarbha—the north-eastern corner of Maharashtra, where Wardha is located—surely count among the other 11. But even the most exalted of trade officials has heard of them. In the past 18 months more than 1,200 farmers in this, the cotton bowl of India, have taken their own lives to escape debts to money-lenders.

These men have become the most poignant example of India's “agrarian crisis”. This was widely blamed for the previous government's defeat in the 2004 election and overshadows India's timorous position in the Doha round of global trade talks, where it heads a group of more than 40 poor countries that want to shelter their farmers from foreign competition. Last year Oxfam, a charity, published a study arguing that the farmers' plight was worsened by their “indiscriminate and forced integration” into an “unfair global system”.

The Vidarbha suicides have many causes, most of them homegrown, says M.S. Swaminathan, the father of India's green revolution. The farmers borrowed money at punitive rates, so they could sink wells and buy costly “biotech” cotton-seeds. But diesel for the pumps leapt in price, and the seeds proved ill-suited to small plots, fed mostly by rain. If the crops fail, “a man loses hope,” Mr Swaminathan says. “He has the moneylender waiting at the door every day and taunting him.”

None of this is globalisation's fault. But farmers have also been hurt by the low world price of their crop, which has fallen by more than a third since 1994. Last season the state government cut the guaranteed price it paid for cotton from about 2,000 rupees ($56) per 100kg to 1750.

Prices are low partly because cotton is so heavily subsidised by rich countries, principally America. The Doha round aims to cut these handouts “ambitiously” and “expeditiously”. If they were cut completely, it might add about 13% to world prices, according to one recent estimate by two World Bank economists. But the Doha round is unlikely to be so slick. A more likely scenario, in which cotton subsidies are cut by a third (and export subsidies eliminated), would add less than 5% to the price.

In the meantime, India's government could impose a “countervailing” tariff on dumped cotton. But cheap fibres please its textile industry, which is keen to take advantage of the end in 2005 of the old global quota regime. India's cotton tariff is just 10%, much lower than its tariffs on other commodities such as sugar. And exporters of yarn and cloth don't even pay that. Cheap cotton keeps the textile mills humming: were subsidies to be removed, India would lose out overall by the equivalent of about $84m, according to the World Bank economists.

In the abstract, the answer to the farmers' distress seems easy: move from growing cotton to weaving it in factories. But India's onerous labour laws inhibit industrial employment, and the lack of a safety net leaves farmers clinging to their marginal patches of land.

There is a deep historical irony in all this. India's long-fibre cotton was introduced by the British in the 19th century to feed the Lancashire cotton mills. Their cheap cloth put India's own weavers out of business: artisans were “thrown back on the soil”. Today India's textile-makers are enjoying a renaissance. If only more of its farmers could escape the soil.

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Presidential hopefuls

Man versus machine

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Barack Obama (almost) declares that he is running for president

AP

THIS week Barack Obama applied a jolt of electricity to American politics—and provided a welcome distraction from the dismal spectacle of an imploding presidency. He did not quite declare that he is running for the Democratic nomination—he will supposedly reveal his final decision in Springfield, Illinois, on February 10th—but he set the process in motion by creating an "exploratory committee", the usual precursor to a run.

Mr Obama's announcement on January 16th gave the media another chance to remind the electorate of his remarkable biography: his mixed-race parentage; his youthful indiscretions; his rapid rise from law professor to state legislator to senator; his star-making speech at the 2004 Democratic Convention. His announcement also reconfigured the Democratic race. Mr Obama's star power means that several second-rank candidates—there are five in the race already and more preparing to enter it—will find it much harder to attract money or publicity.

Mr Obama is the most naturally gifted American politician since Bill Clinton. He is a first-class speaker in a political system where public speeches still matter (far better, by the way, than Mr Clinton was at this stage in his career). He also offers an optimistic message of "political change"—a message that is always welcome in America, but is particularly so after the bitter politics of the Clinton-Bush years. He will have little difficulty in raising the $50m-$100m that is now the entrance fee for a presidential race.

Mr Obama's weakness is as obvious as his talents—his lack of political experience, particularly when it comes to foreign policy. It is true that he is older than John Kennedy was when he became president (45 versus 43). But Kennedy had a much thicker CV—a war record, six years in the House, eight years in the Senate—as well as a reputation as a cold-war warrior. Mr Obama has two relatively undistinguished years in the Senate.

His supporters are touting this inexperience as a positive—a guarantee that their man is not mired in the old politics of division and interest groups. The fact that Mr Obama was not in the Senate during the debates about the Iraq war probably is an advantage: remember John Kerry's fatal dithering on the subject. But the fact that he did not take part in a controversial vote cannot make up for his complete lack of experience in foreign policy. Will American voters really vote for a neophyte at a time when they are entangled in wars in the Middle East and al-Qaeda is doubtless planning another attack?

Presidential politics is about political machines and policy papers as well as raw charisma. Mr Obama has no experience of running a national campaign (many of his advisers are former staffers of two second-division Democrats, Dick Gephardt and Tom Daschle). And his policy prescriptions are strikingly thin. Mr Clinton relished talking about the nuts and bolts of public policy. Mr Obama prefers rhetoric and personal biography.

Mr Obama also has two big obstacles between him and the White House. The first is Hillary Clinton—still undeclared

as a candidate but almost certain to run. Mrs Clinton has some obvious weaknesses. She lacks warmth. Many on the left hate her because of her equivocation on Iraq. But she possesses huge strengths—years of experience at the top of American politics, deep expertise in everything from foreign policy to health care and a political machine that won two elections in the 1990s.

Mrs Clinton not only has access to the best brains on the Democratic side—a government in exile just waiting to take over. She also has access to some of the most ruthless political operators. Mr Obama is now standing in one of the most dangerous places on earth—the road between Mrs Clinton and the White House.

Mr Obama also has a formidable challenger on his left in John Edwards. Mr Edwards possesses some of Mr Obama's qualifications—a gift for rhetoric and a biography that took him from a small town in South Carolina to a Senate seat. But he trumps Mr Obama when it comes to experience. He was the other half of the Democratic ticket in 2004—which, for all its problems, nevertheless won more votes than any other Democratic ticket in history. And he has been running for the presidency ever since.

Mr Edwards has reinvented himself as a fully-fledged populist, renouncing his 2002 Senate vote in favour of the Iraq war and embracing a wide-ranging programme for helping the poor. This message is well crafted to appeal to a Democratic base that is worried about job dislocation, wage stagnation and foreign competition. And Mr Edwards has spent the past two years not just perfecting his message but also turning it into a political campaign.

He has fleshed out his simplistic “two Americas” theme from 2004, burying himself in the policy literature and establishing a poverty think-tank at the University of North Carolina at Chapel Hill. He has also built a formidable machine in the states that get the political season off to a start. He regularly tops opinion polls among Democratic voters in Iowa, which holds the first caucus. He has courted the powerful unions in Nevada, which is hosting the second caucus. And he is the local boy in South Carolina, which holds the second primary.

Mr Obama's announcement is a temporary embarrassment to Mrs Clinton: it makes anything she does for the next week or so look like a response to the charismatic newcomer. But once over that hurdle, she should be able to use the weaknesses of both her main rivals to highlight her own advantages. The lesson from the 2004 primaries is that Democratic voters are so determined to recapture the White House that they will want to plump for the candidate they think can win rather than the one who plays best on their heartstrings. Obama or no Obama, the Democratic race is still Mrs Clinton's to lose.

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The evil weed

Obama's secret vice

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A human in the White House?

IN HIS 1995 memoir, “Dreams from My Father”, Barack Obama confessed to youthful dabbling with pot, booze and “maybe a little blow”. These admissions have not hurt his cause. If anything, they have been taken as a sign of candour. But the senator has at least one more vice. He smokes cigarettes. “It's not something I'm proud of,” he said last year. He is trying to quit. If he fails, some voters may hold it against him.

In the past American presidents have not had to be shy about smoking. When Ulysses Grant told a reporter he liked cigars, well-wishers sent him more than 20,000. FDR used an elegant cigarette holder. Gerald Ford smoked a pipe, and everyone says he was a nice man. Andrew Jackson also had a pipe, made from a corncob. Even First Ladies indulge. Laura Bush reportedly sneaks a cigarette now and then between rounds with “The Brothers Karamazov”.

Still, the modern presidential candidate has little room for error. According to a 2006 Gallup poll, only a quarter of Americans now smoke. Many of those who abstain consider smoking a sign of weakness or intemperance.

Of course, honeymoons have to end. But as habits go, Mr Obama's smoking is less annoying than John Kerry's poetry-writing and less odd than George Bush's obsessive brush-clearing. Americans will have to resign themselves to the fact that no one is perfect, not even Mr Obama. It has also emerged that his middle name is Hussein, and that his ears stick out. If this is the worst that can be said, so much the better for him.

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The president, Congress and the war

A hard sell

Jan 18th 2007 | WASHINGTON, DC
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The administration is on a collision course with Congress. Sort of

Get article background

GEORGE BUSH may occupy the most powerful bully pulpit in the world, but so far he is making little or no headway in selling his latest policy, sending more troops to Iraq. A few days into his sales drive he was even forced to resort to his last-ditch argument—telling Congress that it cannot stop him even if it wants to. In other words, the finger.

The Democrats have come out against Mr Bush's new policy almost to a man. They have been joined by a growing army of Republicans. George Voinovich, a senator from Ohio, says that he can no longer buy into Mr Bush's dream of democratising Iraq; Sam Brownback, a senator from Kansas and a potential champion for social conservatives in the 2008 Republican presidential primaries, says he does not think that “sending more troops to Iraq is the answer”.

No wonder. The public has turned decisively against the war: six voters in ten think it a mistake and seven in ten oppose sending more troops. The Democratic Party's leaders know that they owe their jobs in large part to the growing opposition to the war. And just in case they are inclined to forget, various liberal interest groups, gathered together under the banner of Americans Against Escalation in Iraq, are about to launch a nationwide campaign of advertisements and rallies, including a march on Washington, DC, on January 27th.

But what are these congressional critics likely to do to give force to their criticisms? In theory they have a wide range of levers at their disposal. They can refuse to finance the troop increase. They can put a cap on the number of troops the president can send. They can attach all sorts of strings to the troops' mission. And—the dream of the party's vocal left wing—they can cut off funding for the war completely.

Ted Kennedy, the white-haired lion of liberalism, has drafted a bill requiring the president to get congressional approval for sending in more troops, and is backed by ex-presidential candidate John Kerry. Russ Feingold, a senator from Wisconsin, has urged Congress to “use its main power—the power of the purse—to put an end to this disastrous war”, and Dennis Kucinich, an Ohio congressman, has gone one better and produced a proposal to cut off the money and bring the troops home. Hillary Clinton, just back from Iraq, said on January 17th that she supported legislation to put a cap on the number of troops there.

But congressional leaders are unlikely to pursue either of these two radical options, at least for a while. Harry Reid, the majority leader in the Senate, needs 60 votes to break a filibuster. But he has only the slimmest of majorities, 51. Joe Lieberman, an “independent Democrat”, has come out strongly in favour of the president's plan. Several red-state Democrats, such as Nebraska's Ben Nelson, are reluctant to tackle a president in time of war. And 62 of the current senators voted in favour of the original war resolution.

The House is much more radical than the Senate: only 190 House members remain who originally voted for the war. But even there, plenty of members are worried about direct confrontation—particularly the conservative “Blue Dog” Democrats. It is not just about undermining a president during wartime; the Democrats are nervous about precipitating a constitutional crisis about who has the power to make war—a question which has never been fully resolved.

Congress is likely to opt for a rather softer measure, by passing a symbolic vote of no confidence in the president's plan. Chuck Hagel, a Republican senator, is joining forces with two Democrats, Joe Biden and Carl Levin, on a resolution opposing the build-up. This stamp of bipartisanship will not only embolden other Republicans to break ranks (though Mitch McConnell, the Senate minority leader, has promised to filibuster even such a symbolic measure). It will also send a much more powerful message to the president that support for his policies is crumbling across the board.

The Democrats are also advancing on the president on another front: Iran. In his address to the country on January 10th Mr Bush hinted that he may be opening up a new front against Iran—warning the Iranians that they will no longer be able to support Iraqi guerrillas from across the border with impunity, and declaring that he is sending a second aircraft-carrier and several Patriot anti-missile batteries to the Persian Gulf. This created uproar among Democrats. Mr Biden, the chairman of the Senate Foreign Relations Committee, declared himself willing to spark a “constitutional confrontation” if the president tried to widen the war. Mr Bush's Republican allies in Congress looked

even more nervous than usual.

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Education in New York

Teach us, Mr Mayor

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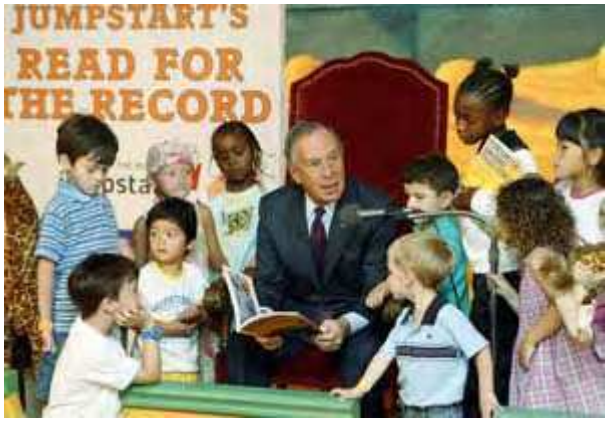
From The Economist print edition

As mayors become leaders of school reform, cities look to New York

Get article background

WHEN Adrian Fenty became mayor of Washington, DC, this month, he immediately announced a plan to take over the city's schools. He is not the first to propose such a scheme, and will not be the last. Although in most cities schools are run by an elected board, this is changing fast. Boston's mayor began the trend of “mayoral control” in 1991: it has spread to Cleveland, Chicago and a dozen other cities and counties, including Los Angeles, where it is now the subject of a court battle. But it is Michael Bloomberg, who took charge of New York's school system—the nation's largest—in 2002, who has become the paradigm of the mayor-educator.

Courtesy of Jumpstart, www.jstart.org



Bloomberg blazes the trail

The sad state of city schools has never been plainer, thanks to testing required by No Child Left Behind, George Bush's 2002 education law. In 2005 51% of fourth-graders in big cities scored “below basic” on a standard reading test, compared with a national average of 38%. Mayors are eager to step in, well aware that bad schools not only harm students, but drive away the middle class and make cities less competitive. But what can mayors do that school boards cannot?

Mr Bloomberg, who gave his state-of-the-city address on January 17th, offers an answer. His power over schools has made him directly accountable for them, streamlined organisation and allowed him to make New York a test-bed for reform. It has also, some say, demonstrated the dangers of letting a mayor's power go unchecked.

As Mr Bloomberg campaigned for mayor in 2001, it was clear that New York's school board was failing its 1.1m students. The board, removed from the city's budget process, had little control over school finances. The consequences were dire. Many high schools were losing more than half their students before graduation. Mr Bloomberg promised change.

With the central school-board disbanded, the mayor got to work. He appointed as his education “chancellor” Joel Klein, a former top trust-buster at the federal Department of Justice. Together, they dissolved the city's 32 school districts and replaced them with ten regions. They chose a uniform curriculum for reading, writing and maths. And they began to close large high schools and open small ones in their place. Mr Bloomberg set up 15 small high schools in 2002, and got money from the Bill & Melinda Gates Foundation in 2003 to help open 169 more.

Two years after seizing control, Messrs Bloomberg and Klein began a push to give more power to certain schools. Management scholars such as William Ouchi, of the University of California, Los Angeles, argued that decentralisation had saved American businesses; it could save schools too. In 2004, New York began opening schools where principals have more control over everything from budgets to staffing. If a principal does not meet the mayor's targets, he can be fired. Last spring, 322 principals, a fifth of the total, joined this “empowerment” programme.

Many parents, teachers and experts—not to mention the mayor—say the reforms are a triumph. Last year Mr Bloomberg's first crop of small high-schools had a graduation rate of 78%, compared with 58% city-wide. The empowerment schools have also shown signs of success, with better rates of attendance and grades.

But some who favoured mayoral control in 2002 now complain that Mr Bloomberg is a dictator, hastily imposing plans after little public input. The uniform curriculum for reading and maths was poorly chosen, argues Diane Ravitch, a professor at New York University. Randi Weingarten, head of the teachers' union, describes teachers using egg-timers to try to follow rigid lesson plans. The effect of the uniform curriculum is unclear. Elementary school students have performed well in some local tests, but their scores in national exams have hardly budged.

Mr Bloomberg's small-schools initiative has also drawn criticism. When the mayor closed big schools to open small ones, many displaced students simply crammed into other schools nearby. David Bloomfield, a professor at Brooklyn College, argues that although the small schools are promising, the rush to open them has placed too great a strain on larger schools, where most students are still enrolled. One Brooklyn high school has as many as 46 teenagers to a class.

Yet the mayor, when faced with complaints, has usually forged ahead. He proved particularly autocratic in 2004, when he announced a plan to keep failing students from advancing to the next grade. A similar scheme in the 1980s did not raise achievement levels and was deemed a failure. But when members of Mr Bloomberg's advisory board opposed the policy, he sacked them. Mr Klein argues that critics' inability to block change is a good thing. City schools, he says, need “bold, tough leadership”. In his state-of-the-city address, the mayor announced yet more reforms, tackling everything from teacher tenure to funding. He plans to disband his ten regions, and give principals even greater autonomy by letting them choose between different methods of support.

Education scholars generally agree that mayors can help failing districts, but they are starting to utter warnings. Last summer the editors of the *Harvard Educational Review* warned that mayoral control can reduce parents' influence on schools. And they pointed to Mr Bloomberg's aggressive style as an example of what not to do. All this must be weighed up by the New York state legislature in 2009, when mayoral control is up for renewal—or scrapping.

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Domestic migration

Dreams of Californication

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How a wave of migrants from the west has transformed the Rocky Mountains

“THEY are all right in the metropolitan areas. But if I sell a rural property to one, I would never disclose where he comes from.” So says Cody Burns, an estate agent, of the single biggest group of migrants to Utah. Mexican immigrants get most of the attention in Washington, DC. In the American West, though, they are less numerous and, in some areas, less unpopular than arrivals from California.

Complaining about Californians is an old tradition in the Rockies; but it is reaching a new intensity. Five million people who were born in California now live outside the state. They are America's second-biggest domestic diaspora, after New Yorkers, and the most noticeable. California is by far the most populous state in the West—and still growing rapidly. It has become a demographic machine, drawing in foreigners while disgorging its own population across the deserts and mountains. In the process, it transforms those areas.

The exiles' most obvious impact is on housing. “People from California, who pay a fortune for tiny places, find this to be an appealing market,” says Rocky Anderson, the mayor of Salt Lake City. Property prices have soared across America during the past decade. In absolute terms, though, they have risen fastest in cities such as Los Angeles and San Francisco.

The price imbalance between the coast and the interior West means that “equity refugees” from California have big buying power. In Daybreak, a development south of Salt Lake City, many of the big houses are sold not to local Mormons (who have the largest families) but to new arrivals from the west. Californians account for more than a quarter of the homes bought in Promontory, an expensive, golf-oriented town just outside Park City, according to CS Financial, a mortgage-broker.

Although Californians' eyes widen when they first see prices in the Rockies, moving to a relatively cheap market can be hazardous. Tom Clark, who is currently helping some 400 aerospace engineers to move from southern California to Denver, says many worry that prices on the coast will rise beyond their reach. One reason the Californian diaspora is so large is that, once people leave, they often cannot afford to go back.

Still, house prices in metropolitan Salt Lake City rose by 19% between 2005 and 2006—one of the steepest increases in the country. The problem is that local first-time buyers can be priced out of the market. To make matters worse, Californians, who prize privacy and security, often fortify their properties. They may even object to armed men traipsing across their land in search of game.

To sum up this and other affronts, westerners have used a verb. To “Californicate” a state means to turn it into an image of California, with inflated property prices, traffic jams and rampant crime. Occasionally, as in a recent leader in the *Las Vegas Review-Journal*, a local political shift (in that case, Nevada's vote to ban smoking in restaurants) is described as Californication. And Californians have indeed spread their politics to other states.

“I wouldn't be mayor without them,” says Mr Anderson of Salt Lake City's immigrants. And it is true that a list of the mayor's activities in his office reads like a California Democrat's: setting a greenhouse-gas reduction target for the city, blocking a proposed highway and protesting against a visit by George Bush.

Californian immigrants have changed Colorado's politics not once but twice, according to John Hickenlooper, Denver's mayor. First, in the late 1980s and early 1990s, came conservative, often evangelical exiles from Orange County, south of Los Angeles. They brought a Californian enthusiasm for limited government. Ballot measures imposing term limits and restraining tax increases were soon approved by Colorado's voters, together with a fiercely anti-gay measure.

Then, beginning in the late 1990s, a wave of northern Californians arrived to take up jobs in Colorado's growing high-technology sector. Young, well-educated and liberal, they are a big reason Colorado has moved out of the Republican camp in the past few years, says Floyd Ciruli, a Denver pollster. Four years ago Colorado Republicans had the two US senators, five out of seven congressmen, the governor and control of both houses of the state legislature. They now have just one senator and three congressmen. And this week that senator, Wayne Allard, announced that he will stand down in 2008.

The new conquistadors

At one time the Californian exodus could fairly be described as white flight. No longer. Between 1995 and 2000, California suffered the net loss of more Hispanics than whites. Many of them were members of the well-off working class, and were lured by the construction boom in the mountains and desert. Most were barely noticed: a Hispanic in Denver or Las Vegas is generally assumed to have come from Mexico. A few, though, have become notorious, thanks to California's most despised export—its gangs.

Although Denver does not have a Crenshaw Boulevard, it has a Crenshaw Mafia gang, which is named after a street in Los Angeles. Salt Lake City has a 38th Street gang, which also originated in southern California. Gang graffiti in Salt Lake City occasionally features Californian telephone codes, such as 310 and 714, and allusions to sections of the state's penal code.

A few Rocky Mountain thugs do indeed hail from the west coast, and high-level investigations into drug trafficking often turn up evidence of Californian suppliers. But in most cases, police say, links with west-coast gangs are more aspirational than real. “Los Angeles gangs are the most violent in America and they run the most drugs. If you have pretensions to be a serious gangster, you want to associate yourself with them,” says Chris Burbank, head of Salt Lake City police.

Such malign influences, even if they are mostly imagined, pain those who have found homes in the interior. “We came to Colorado because it reminds us of how California used to be,” says Hank Baker, a property developer. Yes, goes the local quip—and the new arrivals are gradually turning the West into a version of California as it now is.

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The North Pacific great circle route

A cold coming we had of it

Jan 18th 2007 | DUTCH HARBOR
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Shipwrecks in the Aleutians

THE few people who live in Alaska's Aleutian Islands have long been accustomed to shipwrecks. They have been part of local consciousness since a Japanese whaling ship ran aground near the western end of the 1,100-mile (1,800-km) volcanic archipelago in 1780, inadvertently naming what is now Rat Island when the ship's infestation scurried ashore and made itself at home. Since then, there have been at least 190 shipwrecks in the islands.

In the past decade, shipwrecks have become less frequent, but larger. In 1997 the *Kuroshima*, a freighter, ran aground on Unalaska Island—home to the Aleutians' only four-figure population—spilling 39,000 gallons (148,000 litres) of heavy fuel. In December 2004 a Malaysia-flagged freighter, the *Selendang Ayu*, lost power and crashed into the northern shore of Unalaska, splitting in half in a subsequent storm and spilling some 328,000 gallons of fuel, the worst such incident in Alaska since the *Exxon Valdez* was wrecked in Prince William Sound in 1989.

Then there are the close calls. On July 23rd last year the *Cougar Ace*, a Singapore-flagged car carrier transporting 4,700 Mazdas from Japan to Vancouver, rolled onto its side south of the Aleutians. Salvage contractors, aided by unusually good marine weather, were able to tow the listing ship into Unalaska Island's port of Dutch Harbor. In December, a bulk freighter loaded with wheat limped into Dutch Harbor with engine problems similar to those that led to the *Selendang Ayu* disaster.

The reason so many large vessels meet unhappy ends in the Aleutians has to do with the geography of international shipping. The archipelago is a hazardous traffic median in the great circle route, the shortest path between ports on either side of the North Pacific. An estimated 3,100 large vessels thread between the islands each year on their way west, and a similar number travel the eastward route across the North Pacific just south of the Aleutians.

Traffic is likely to increase along with the growth of international trade, but there are few safeguards in place. The nearest large rescue tugboats are stationed in Prince William Sound, too far away to be of much use. Vessels over 300 gross tonnes must carry automatic identification system (AIS) transmitters, but the two AIS receivers in the Aleutians only cover about 10% of the islands. Foreign-flagged vessels are not required to carry plans for oil spill response or salvage, except for ports where they intend to dock.

This lack of maritime surveillance and disaster preparedness is not unique to the great circle route, but the nasty local conditions are. The storms that routinely batter ships on the Bering Sea are legendary.

A full-scale safety review is in the pipeline, but in the meantime a big oil terminal on the southern end of Russia's Sakhalin Island could open this year, resulting in a spike in eastward oil tanker travel along the route. And the Bush administration's decision on January 9th to lift a moratorium on oil drilling in nearby Bristol Bay, where Shell hopes

to develop natural gas resources, could further increase Aleutian traffic. Expect more wrecks.

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Lexington

A falling star

Jan 18th 2007
From The Economist print edition

Condoleezza Rice is not the woman she once was

Kevin Kallaugher

A COUPLE of years ago Dick Morris, an estranged former Clinton adviser, published “Condi vs. Hillary: The Next Great Presidential Race”, which argued that Condoleezza Rice was the only person who could save America from a Clinton restoration. Since then Mrs Clinton has gone from strength to strength, and is preparing to announce her presidential candidacy any day now. Ms Rice has taken a relentless battering.

The secretary of state spent this week on a tour of the Middle East before touching down in Germany and Britain. Her aim is to encourage Arab moderates to side with America in stabilising Iraq and the wider Middle East. Her bait is a promise to the Arab world that she will put more American muscle behind the creation of a Palestinian state. All worthy goals. But few people think that she can make much difference.

Ms Rice left home with a flea in her ear. On January 11th the Senate Foreign Relations Committee savaged her for the administration's failures in Iraq. Criticism from the newly ascendant Democrats was perhaps predictable. But she got more of the same from her Republican colleagues. Chuck Hagel said that the administration's new plan in Iraq might be “the most dangerous foreign-policy blunder in this country since Vietnam”.

The secretary of state kept her famous poise throughout the grilling, even when Barbara Boxer cattily remarked that she did not have any children who might be killed in Iraq (Ms Rice is unmarried and childless). But the criticisms were nevertheless telling: as national security adviser in George Bush's first term, Ms Rice bears almost as much responsibility for the mess in Iraq as Mr Bush, Dick Cheney and Donald Rumsfeld.

Her fingerprints are on some of the worst mistakes of the first Bush term. She claimed the White House was unaware of the CIA's doubts about whether Saddam Hussein had tried to buy yellowcake uranium in Niger, for example, despite the fact that her office had received two memos on the subject and a call from the CIA director. But her culpability is deeper than that. When Ms Rice ran the National Security Council (NSC), it was hopelessly dysfunctional—torn asunder by disputes between the hawks (Mr Cheney and Mr Rumsfeld) and the doves (then secretary of state Colin Powell and his deputy, Richard Armitage).

Dealing with a feud between such big political beasts was probably too much for anybody, let alone a relatively inexperienced newcomer. And Mr Bush bears ultimate responsibility for the acts of his administration. Still, Ms Rice spent more time with her boss than anybody else, briefing him every day and spending weekends with his family. She could have done more to force him to listen to Mr Powell's warnings, which he was temperamentally inclined to ignore. She could also have done more to warn him about the lack of preparation for post-Saddam Iraq.

Ms Rice was given a chance to redeem her reputation when she was made secretary of state in the second Bush

term. Mr Bush signalled that he wanted a different foreign-policy approach from his first, which Mr Armitage once characterised as “Look, fucker, you do what we want.” She dreamed of reinforcing the expansion of America's hard power with an expansion of its soft power. And she brought valuable resources to her mission: a close relationship with the president, a penchant for multilateralism, a collection of deputies who wanted to reach out to the UN, and, for a while, an adoring press. But her bubble was burst by Israel's invasion of Lebanon. The administration started by trying to give Israel the time it needed to destroy Hizbullah. Ms Rice declared that the world was witnessing “the birth pangs of a new Middle East”. The policy was a disaster: America eventually had to broker a deal that left Hizbullah triumphantly in place. Ms Rice's words continue to haunt her on her current tour of the Middle East. If she is so keen on democracy, why is she cosying up to dictators in Egypt and Saudi Arabia?

The state of State

Ms Rice has also proved a disappointing manager of the State Department—the institution that was supposed to be the engine of a new diplomatic offensive. She has lost her number two, Robert Zoellick, and her personal adviser, Philip Zelikow, both impressive men, and still has a significant number of positions to fill. The department spent an unprecedented six months finding a replacement for Mr Zoellick.

These failures are surprising given Ms Rice's career before she entered government. As a child growing up in segregated Alabama, she concluded that she needed to be “twice as good” as whites in order to succeed, and notched up a stunning record of achievement—becoming a fine pianist and figure-skater as a child, graduating from university with top honours at 19, earning tenure at Stanford University at a tender age, and becoming provost of the university at 38.

But the traits that made Ms Rice such a perfect protégée may be working against her now she is at the top of the tree. Ms Rice made her career by impressing powerful establishment figures—from Brent Scowcroft (who brought her into the NSC when she was 34) to Messrs Bush senior and junior. But what happens when your patrons disagree about fundamentals? Ms Rice tried a dose of fudge during the first Bush administration (you can find people on both sides of the diplomatic wars of the first term who believed that she was on their side). But mostly she chose to flatter her current patron.

Ms Rice started her career as a tough-minded realist who was sceptical about nation-building and democratisation. She might have chosen to restrain her boss's Manichaean instincts with a dose of that realism. Instead she went along with him. Being a perfect protégée can get one a long way up the greasy pole. But it is not the best qualification for being a successful secretary of state—let alone a candidate for president.

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Canada

Warming to the one-candle man

Jan 18th 2007 | OTTAWA
From The Economist print edition

Peter Schrank

After a year in office, Stephen Harper's no-nonsense government has shown itself to be effective but its longevity is still uncertain

Get article background

IN FREAKISHLY warm weather, Stephen Harper met the press earlier this month in the snow-free gardens of his official residence to discuss his new-found commitment to the environment. He candidly admitted that his Conservative minority government had let the public down when it presented a climate-change plan whose main targets were set 50 years in the future, and vowed to do better. He promptly named a new environment minister with a reputation as a political pitbull.

A different politician might have chosen a different backdrop for this confession of failure. But as Canadians have learned from watching Mr Harper over the past year, their young prime minister is not a man to dodge realities, however unpleasant. On issues ranging from revisiting same-sex marriage to ending favourable tax treatment for business entities known as income trusts he has followed his instincts rather than the opinion polls.

It has worked. Instead of falling within months, as Canada's liberal punditocracy had predicted, Mr Harper has become an increasingly assured performer. The talk in Ottawa now is that, despite commanding just 125 of the 308 seats in the House of Commons, his government may even manage to carry on until 2008.

Mr Harper took office in favourable circumstances. The Liberals, whom he ousted a year ago, bequeathed a robust economy and a large fiscal surplus. They did this despite lavishing large dollops of extra money on the health service, which has kept normally querulous provincial premiers happy. A dozen years in government left the Liberals tired, divided and discredited. They were in leaderless disarray until last month.

The prime minister has avoided making any big mistakes. Unlike his predecessor, Paul Martin, who had so many priorities he had none, Mr Harper has focused on just a few issues and concentrated on doing what he promised. He summed up his philosophy by saying, “I believe it's better to light one candle than to promise a million light bulbs.”

He has carried out four of the five chief policies he set out in the election campaign: money for child care, a cut in the sales tax, tougher laws against street crime, and legislation to make politicians and the civil service more accountable. Completing the fifth—a cut in patients' waiting-times—depends on the provinces.

Mr Harper has been able to get things done partly because he centralised more power in the prime minister's office. Cabinet ministers must clear all their big speeches and news releases with prime-ministerial staff. Mr Harper makes all the key announcements himself, the relevant minister just a nodding head in the background. In this he is following a trend in Britain and other countries, notes Donald Savoie, a professor of government at the University of Moncton.

Although ministers with large egos might chafe, they have not done so publicly. There have been few leaks to the media. To help steer the ship of state, Mr Harper hired a seasoned first mate in Kevin Lynch, a senior financial official recalled from a post at the IMF to head the civil service. The result is a government that conveys unusual clarity of

purpose.

Opinion polls show that Canadians approve of Mr Harper's leadership, but that has not rubbed off on his party. Recent polls have put the Conservatives neck-and-neck with the Liberals, both at between 30% and 35%. In Canada's regionalised party system, changes in allegiance take place slowly, says Roger Gibbins of the Canada West Foundation, a think-tank in Alberta. Others note that uncommitted voters may want to see more of Mr Harper before they convince themselves that he does not plan to inflict social conservatism on them, as opponents have claimed. “Conservative numbers go up when they focus on fiscal issues,” says Nik Nanos, a pollster, “and down when they start freelancing on social issues like same-sex marriage, the gun registry and crime bills.”

The year ahead promises to be harder. Mr Harper has now committed himself to a stronger policy on climate change, which will not be easy to achieve in such an energy-hungry country. A House of Commons committee is reviewing the issue: if it recommends stricter targets than Mr Harper wants, he could face a damaging fight.

The provincial premiers want the prime minister to act on his promise to redress “the fiscal imbalance”. In other words, they want more federal money. That demand comes most vocally from Jean Charest, the premier of Quebec, who is expected to call his own election this spring. Mr Harper's best hope of winning a majority at the next federal election lies in picking up seats in Quebec. But the “fiscal imbalance” is a Pandora's box that Mr Harper opens at his peril.

Then there is foreign policy, where Mr Harper looks less assured. He has repaired relations with the United States, which frayed under the Liberals. But Canadians do not like their governments to be subservient to their more powerful neighbour. His opponents accused Mr Harper of just that when he extended Canada's military deployment in Afghanistan until 2009. That could become very unpopular if casualties mount (so far 45 Canadians have died there in the past four years).

Mr Harper's warmth towards the United States contrasts with his coldness towards China, which he has criticised for human-rights abuses. Chinese trade and investment are increasingly important for western Canada. This month he sent the finance and trade ministers to Beijing in an apparent effort to mend the breach.

The coming year will either make or break Mr Harper. He faces tougher opposition. The new Liberal leader, Stéphane Dion, is both an environmentalist and a Quebecker. Minority governments in Canada last an average of 18 months. Nobody in Ottawa is in a rush to force a new election. But sooner or later, Mr Harper's government will fall on a parliamentary vote of confidence. He is a skilful parliamentary tactician, and may be able to pick the issue on which that vote will come. The broader test of his qualities as a political leader will be whether he has chosen the right candles to hold up to the electorate.

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Ecuador's new president

Magical mystery tour

Jan 18th 2007 | QUITO
From The Economist print edition

Correa puts his left foot forward

Get article background

WILL Rafael Correa, Ecuador's new president, propel his country along the same anti-American, autocratic and socialist path as Hugo Chávez has led Venezuela? To judge by the company he keeps and the tone of his speeches, the answer would seem to be yes.

At his inauguration on January 15th, Mr Correa accepted a replica of the sword of Simón Bolívar, the South American independence hero, from Mr Chávez. He welcomed Iran's president, Mahmoud Ahmadinejad. His vice-president is called Lenín Moreno.

EPA

Follow me to constitutional heaven

Mr Correa, an economist who calls himself a “Christian leftist” and claims to be leading a “Citizens' Revolution”, railed against “neoliberalism”, which he claimed had been “disastrous” for Ecuador. He said that some of the foreign debt was “illegitimate” and that he would renegotiate it “firmly”, along with contracts with foreign oil companies.

He signed a decree calling a referendum on March 18th on convening a Constituent Assembly. This would wrest power from the Congress and what he sees as a corrupt “partyocracy”. He also doubled (to $30 a month) a welfare payment to 1m poorer Ecuadoreans.

Mr Correa's talk may turn out to be more radical than his actions. He has yet to specify whether he will default on the debt, or seek a voluntary restructuring. He has dropped his past opposition to Ecuador's use of the American dollar as its currency. He reached agreement with Colombia's president, Álvaro Uribe, to allow some aerial fumigation of coca crops near the border between the two countries. As for Mr Moreno, he is a “laughter therapist”, not a Bolshevik.

Mr Correa's biggest gamble is the assembly referendum. This must be approved by the electoral tribunal and, opponents say, by the Congress. Lucio Gutiérrez, a former president, gave his backing. But Mr Correa wants nothing to do with the Congress or other politicians (he called Mr Gutiérrez a “viper”).

Mr Correa is armed with oil revenues. His effort to dissolve Congress may work. But it may not. When Mr Gutierréz dissolved the equally unpopular Supreme Court in 2005, the Congress and irate middle-class demonstrators overthrew him. As in Bolivia, the more prosperous lowlands may resist highland socialism.

Ecuador certainly needs reform. Rather than “neoliberalism”, it has suffered at the hands of special interests, such as the political cabals in Congress, and bankers who have twice been bailed out by the taxpayers. Whether or not Mr Correa's cure will be worse than the disease should soon become clearer.

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Colombia

Bullet points

Jan 18th 2007 | MEDELLÍN
From The Economist print edition

A paramilitary leader confesses

Get article background

FOR the victims of the violence of Colombia's paramilitary militias, hearing their tormentors confess is painful, potentially liberating—and unprecedented. For those among the country's politicians, military officers and officials who worked hand-in-glove with the outlaw groups, the revelations could land them in jail.

In a courtroom in Medellín on January 15th, Salvatore Mancuso became the first senior paramilitary leader to make a voluntary confession of his involvement in kidnappings and mass murders. In two days of depositions, Mr Mancuso used PowerPoint presentations to recount his crimes chronologically from 1992 to 2003. He gave details of 87 different operations which led to the deaths of more than 300 people. Relatives of the victims watched on closed-circuit television.

The paramilitary groups were originally formed by cattle ranchers in the 1980s to combat extortion and kidnapping by left-wing guerrillas. They later turned into powerful armies that inflicted terror on many areas of the country, killing guerrillas and civilians alike. Like the guerrillas, many were involved in drug trafficking.

Some 30,000 paramilitaries have demobilised under a peace deal with the government of President Álvaro Uribe. In exchange for confessing and paying reparations, their leaders are eligible for reduced sentences of no more than eight years' confinement; they will also not be extradited to the United States to face drug-trafficking charges.

Nearly all the politicians and army officers implicated by Mr Mancuso are dead or already convicted. Several times the prosecutor taking his deposition chided him to name “someone who's alive”, say lawyers for the victims. Even so, Mr Mancuso's revelations are valuable in establishing the historical record, according to Gustavo Gallón of the Colombian Commission of Jurists. The deposition is only the first stage of the special judicial process under the peace deal. “There's a lot to be explored here,” said Mr Gallón.

Among Mr Mancuso's most explosive revelations was that he met the late General Alfonso Manosalva, the commander of the army's fourth brigade, to plan an operation in 1997 at El Aro, in Antioquia department, which resulted in the killing of 15 people. He said that in one region alone his militia group had a monthly budget of about $450,000 to pay off police agents and army officers.

Mr Mancuso's deposition was suspended until later this month just as he was about to say how his group was financed. He is wanted in the United States on charges that he shipped 17 tonnes of cocaine. As part of his commitment to reveal the truth—and thus escape extradition—he will have to give details of trafficking routes and contacts.

The head of the armed forces, General Freddy Padilla, distanced his institution from involvement with the paramilitaries, saying that if any individual officer broke the law “he'll have to face justice alone.” Some human-rights groups worry that the paramilitaries will get off without a full confession of their crimes. But nothing quite like Mr Mancuso's day in court has happened before in Colombia—and the process may not end there.

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Brazil

Blame it on Rio

Jan 18th 2007 | RIO DE JANEIRO
From The Economist print edition

New leadership for a troubled icon

"DO YOU know that Rio's economy is around $130 billion, the same size as Venezuela's?" asks Joaquim Levy, the new finance secretary of Rio de Janeiro's state government, pulling a crumpled sheet of notes from his pocket. Many Brazilians might retort that their iconic former capital suffers from Venezuela's woes: an economy distorted by oil, rampant crime and a history of irresponsible government. But Mr Levy, who has worked as a top official in Brazil's finance ministry and at the Inter-American Development Bank, is part of a determined effort to change that: "My job is to find a way to make Rio a good place to do business again."

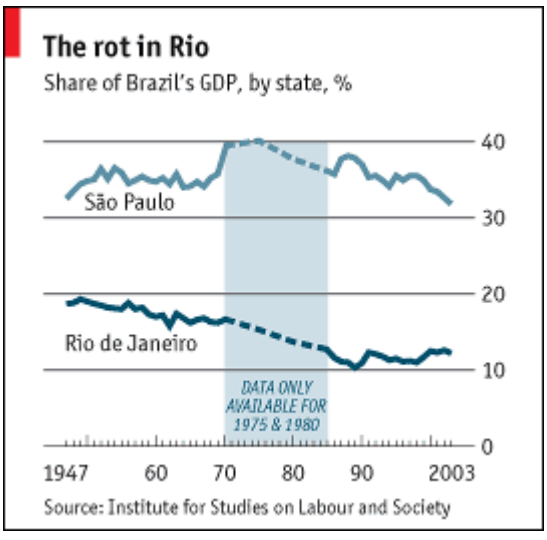
That will take some doing. According to police figures, Rio suffers 42 murders a year for every 100,000 citizens (others put the figure at 50). That makes it one of the bloodiest cities in the Americas, and twice as dangerous as its bigger rival, São Paulo, where violent crime has fallen by half since 1999. In a rampage by drug traffickers last month, 19 people were killed, scores more injured, and nine buses set aflame. The chronic lawlessness has driven away businessmen and investment.

AP

Awaiting liberation from violence, red tape and misgovernment

Mr Levy's boss, Sérgio Cabral, who took office as state governor on January 1st, immediately broke the stubborn local taboo against calling for help. On January 14th Brazil's president, Luiz Inácio Lula da Silva, sent 500 members of an elite anti-crime force. Instead of appointing political cronies, Mr Cabral has named outsiders to other top jobs. "We are optimistic," says Orlando Diniz, the president of the chamber of commerce. "Rarely has there been a political moment as auspicious as this."

The violence is only part of the city's malaise. It never really recovered from losing its status as Brazil's capital to Brasília in 1960. Over the subsequent decades much business departed for São Paulo (see chart). Rio's boosters point to new investment in textiles, fruit, a new deepwater port and a resurgent steel and shipbuilding industry. Four-fifths of Brazil's output of 1.7m barrels a day of oil is pumped from wells off Rio's shores, decanting some $3 billion in revenues to state coffers.



But since 1985, employment in Rio has grown at a slower rate than in any other of Brazil's 26 states. And much of the new investment is in smaller towns in the state, rather than the city. The economy of the Rio de Janeiro metropolitan area is no bigger than it was a quarter of a century ago.

Many of Brazil's national afflictions, such as crippling taxes and a jungle of red tape, are at their most acute in Rio. According to the World Bank it takes two years to collect a commercial debt—longer than in any other big Brazilian city—and three months to set up a company. According to Mr Levy, "there's so much hassle, people say 'why bother?' One of Rio's biggest problems is complacency."

That may be partly because the city is full of pensioners. Some 45% of the wealthiest families in Rio draw their main livelihood from retirement benefits, according to the Institute for Studies on Labour and Society, a think-tank in the city. "There is no way a society that values the past more than it does the present can progress," says André Urani, of the institute.

To make matters worse, nearly all of Rio's state governors since democracy was restored in the 1980s have been populists. The latest two were a husband and wife team of evangelical protestants, Rosinha Matheus and Anthony Garotinho, who ran the state with a Bible in one hand and cheque book in the other.

They left the state's finances in a shambles. One of Mr Levy's first jobs was to scrape up the money to honour unpaid wages. Next comes taming public spending, which rose 20% last year, and simplifying taxes. “If you create a business-friendly environment, you'll get a tremendous response,” says Mr Levy. If he is right, Rio may just have reached a turning point.

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About sponsorship

AIDS in China

Blood debts

Jan 18th 2007 | SHUANGMIAO, HENAN PROVINCE
From The Economist print edition

Imaginechina

Tens of thousands of lives devastated. Not a single official held to account

Get article background

WALKING through the village of Shuangmiao, Zhu Longwei points out the houses of families unaffected by HIV, the virus that causes AIDS. They are few and very conspicuous: imposing grey-walled structures towering over clusters of old dilapidated homes. Mr Zhu, whose wife has HIV, is uneasy about escorting a journalist in broad daylight. For years, Shuangmiao has been off limits to the press. Officials—whose negligence and greed created Shuangmiao's HIV nightmare—routinely detain and expel any reporters they find.

The village, and many like it, is a victim of China's biggest public-health scandal of recent decades. In the early 1990s, local officials encouraged peasants to supplement their meagre incomes by selling blood plasma. Many Chinese are loth to give blood, believing it might weaken them. But the peasants were told they would get the blood back once the plasma had been removed. They were not told of the enormous risks. There would be no tests for HIV. The blood would be re-infused after being pooled with other donors'. So any virus would spread.

The United Nations estimates that at the end of 2005 there were 55,000 commercial blood and plasma donors infected with HIV in China. Most contracted the virus before the central government began tightening controls over the business in the mid-1990s. One Chinese AIDS expert, Zhang Ke, reported in 2004 that the figure for Henan province in central China, to which Shuangmiao belongs, could be more than 170,000. Dr Zhang estimated that a further 130,000 in Henan got the virus from transfusions in hospitals.

Having tried to play down its HIV problem, and suppress news coverage and public discussion about it, China decided four years ago to try a little openness. This was prompted by the inept handling of an outbreak of severe acute respiratory syndrome, or SARS, which showed how official attempts to maintain secrecy about the spread of infectious diseases could simply make things worse. But officials in Henan, as well as some in Beijing, remained just as determined to suppress news of what had happened in villages such as Shuangmiao in the 1990s.

Victims and activists say that not a single official has been punished for his role in the plasma trade, during the height of which even police and army units set up plasma-buying stations to boost their incomes. Nor do they know of any doctor who has been punished for giving patients infected blood. To make money, hospitals at that time often prescribed unnecessary transfusions. Many victims and activists resent Li Changchun, then Henan's Communist Party chief and now China's eighth-highest ranking leader, for not intervening sooner. They also blame Li Keqiang, his successor in Henan, first as provincial governor and then as party chief, for allowing the cover-up. Mr Li, now party leader of Liaoning province in the north-east, is tipped for promotion to the Politburo later this year.

New regulations on reporting in China by the foreign press may help to shed more light. The rules, which took effect on January 1st and are intended to facilitate coverage of the Olympic Games in Beijing in August 2008, mean resident correspondents no longer require government approval for reporting trips in the provinces. Mr Zhu and several other villagers in Shuangmiao watched in surprise as a group of local officials trying to stop your correspondent from interviewing him apologised and retreated after an intervention by the foreign ministry in Beijing.

But few expect justice to be meted out soon. In the provincial capital, Zhengzhou, Gao Yaojie, a 79-year-old retired doctor (pictured above), who seven years ago was instrumental in exposing the extent of Henan's HIV infection, says she is even worried that someone might try to kill her. Dr Gao, who now plays a big part in private relief efforts for Henan's HIV carriers, believes her telephone is tapped. Her books on Henan's “AIDS villages” are banned in the province, she says. When visiting the villages, she stays in cheap lodgings where staff are less likely to report her presence to the authorities.

Victims complain of continuing pressure to stay quiet. Li Xige, an activist who says she contracted HIV from a transfusion during a caesarean operation, was placed under house arrest last month in her hometown of Ningling, a few kilometres from Shuangmiao. She had angered the authorities by protesting outside the health ministry in Beijing in July, calling for redress for dozens of local women similarly infected. The health ministry invited her to discuss the issue, but when she turned up for the meeting she was detained in the ministry compound by Ningling officials and escorted back to Henan.

It is not just local officials who are sensitive. The party's propaganda department, which is under the supervision of Li Changchun (the former Henan chief), is just as prickly. Yan Lianke, a well-known writer who wrote a semi-fictional novel based on visits to an AIDS village in Henan, says his work was banned in a secret order issued by the propaganda department and the government's General Administration of Press and Publication as soon as it reached bookshops a year ago.

Mr Yan says that he had even deleted some details of official involvement in the blood business. The publisher, in Shanghai, submitted a court claim in September arguing that it was no longer bound by some of its contractual obligations, including a donation of 50,000 yuan ($6,400) to the victims. The book, said the claim, had “harmed the country's reputation”. The court's decision is awaited.

In Henan, the authorities may be hoping that time is on their side. Of Shuangmiao's roughly 3,000 people, villagers say more than 500 have contracted HIV. Of these, more than 200 have died. The government began distributing free anti-retroviral drugs in Shuangmiao and nearby villages in 2004, but villagers complain of bad side-effects and growing resistance to the medication. After your correspondent's departure, local officials called on Zhu Longwei. He was not to give any more interviews, they said, or he would have to “bear the consequences”. Mr Zhu says he is undeterred. Few will be so bold.

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About sponsorship

India and Pakistan

Up Sir Creek

Jan 18th 2007 | DELHI
From The Economist print edition

The peace process inches forward

Get article background

A COLONIAL place name can sometimes denote a lingering territorial dispute on the Indian subcontinent. One example is the Durand Line (see article) between Pakistan and Afghanistan. Another is Sir Creek, a muddy puddle by the Arabian Sea that remembers a British official who settled a row about firewood there—and which should mark the still-undelimited maritime border between India and Pakistan. On January 13th, as a significant notch in a gradual peace process, India's foreign minister, Pranab Mukherjee, visited Islamabad to discuss Sir Creek and other disputes. Two days later, Indian and Pakistani surveyors began mapping the creek to prepare for further wrangling on where the border should lie.

Given the rivals' terrible history, including three wars, one of them partly over Sir Creek, this was more evidence of the resilience of the three-year-old peace process. Mr Mukherjee's trip was the first by a foreign minister since the process was frozen last year, after India implicated Pakistan in bomb blasts in Mumbai in July. Violence could again derail the process, and is always possible. On January 17th two Indian soldiers were allegedly wounded in a shoot-out with Pakistani troops along the front-line, known as the line of control (LOC), that divides the most bitterly contested territory, Kashmir. But otherwise the coming two months will see a rush of diplomacy, including visits to Delhi from Pakistan's foreign and prime ministers.

The dialogue's achievements are already considerable. India and Pakistan now co-operate on many issues, from limited bus services across their borders to communication at sea. Progress has even been made on settling their three main territorial disputes: Sir Creek, the Siachen glacier that rises at the north-eastern end of the LOC and Kashmir itself.

Sir Creek is the easiest to resolve. India says the border runs down the puddle's deepest channel; Pakistan puts it along the puddle's eastern bank. At stake is a long sliver of sea and perhaps gas reserves under it. There is a deadline: a UN convention gives its signatories, including India and Pakistan, until 2009 to fix their maritime waters, or lose rights over them.

Resolving Siachen, a battlefield of crag and ice, where India holds the heights, looks deceptively simpler. The terms of a settlement, by which both sides would mark their positions and withdraw their troops, have been more or less

decided. But neither side trusts the other to keep its word. Shortly before the blasts in Mumbai, India's army chief issued a warning against India vacating the high ground, so possible did a settlement then seem. This week, he did not repeat his warning, apparently reassured by Manmohan Singh, India's prime minister, who said talk of settling Siachen was “premature”.

Resolving the future of Kashmir, which is mostly Muslim, divided, and in the Indian part ravaged by local and foreign insurgents and a brutal security regime, will take longer. At the least, General Pervez Musharraf, Pakistan's president, has suggested what a resolution might look like: no territorial changes, but, to save Pakistani pride, greater autonomy for Kashmiris on both sides of the LOC, and some co-operative (or “joint management”) bodies involving both India and Pakistan.

General Musharraf's proposal is promising, but to mould it into a solution acceptable to both sides will probably take years not months. And that assumes no big upsets along the way. “With India and Pakistan, one incident can knock us back to square one,” says Umar Farooq, a leading moderate separatist in Indian-held Kashmir. He should know.

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About sponsorship

Afghanistan and Pakistan

They walk the line

Jan 18th 2007 | KABUL
From The Economist print edition

A border dispute disguised as a counter-insurgency strategy

“IT'S going to be a violent spring,” is the blunt assessment of General Karl Eikenberry, the senior American commander in Afghanistan. Insurgents allied to the Taliban are believed to be planning a big offensive. NATO had hoped its soldiers in Afghanistan could forestall this during the winter, through a mixture of military pressure on the Taliban and huge amounts of civilian aid. That strategy is in tatters.

Afghan and American officials lay much of the blame on Pakistan, for providing havens for the Taliban. General Eikenberry highlighted the stretch of border opposite North Waziristan where the Islamabad government struck a peace agreement with tribal leaders and militants last September. This week, Afghanistan produced a video of a captured Taliban spokesman, alleging that the group's leader, Mullah Omar, was under Pakistani protection in the city of Quetta. Pakistan pooh-poohed the claim.

Before the latest row, Pakistan had revived the idea of fencing and mining the 2,500km (1,560 mile) border with Afghanistan, ostensibly to restrict the movement of Taliban fighters. Afghanistan and the UN objected that this would endanger civilian lives and divide the Pushtun tribes straddling the frontier. Thousands of tribesmen on the Afghan side of what is known as the Durand Line were rounded up to protest against the plan.

The issue smells pungently of red herring. No Afghan government has accepted the Durand Line (see map), which was drawn up by Britain in 1893. Pakistan's ruse is to deflect criticism about insurgents crossing the border, while staking its territorial claim. American military-intelligence officials say that Pakistani border guards often allow insurgents to cross at checkpoints.

The Durand Line is a sensitive issue for Pakistan, which has seen attempts by both Pushtun secessionists and Afghan irredentists to carve away chunks of the frontier. But the Afghan president, Hamid Karzai, a Pushtun, does not want to be the man who abandoned the claim for a Greater Afghanistan.

As was perhaps intended, the idea of fencing and mining the border is now obscured in a fog of debate. America and its allies, Pakistan and Afghanistan, are facing the looming spring offensive with worrying disunity.

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Bangladesh

The coup that dare not speak its name

Jan 18th 2007 | DHAKA
From The Economist print edition

The army, not the politicians, now runs Bangladesh

Get article background

Reuters

Between the barracks and the mosque

WHEN Iajuddin Ahmed, Bangladesh's president, declared an army-backed state of emergency on January 11th and cancelled the election due on January 22nd, neither he nor the foreign governments quietly cheering him on used the word “coup”. Yet that is what it looks like. The army, in the tradition of “guardian coups” from Fiji to Thailand, has stepped in with the usual list of apparently noble goals. The interim government it is backing will enable credible elections, clean up the country's extremely politicised civil service, fight corruption, fix the country's power crisis and keep food prices in check—and then return to the barracks.

The president stood down as head of the caretaker government that had been supposed to oversee the elections. He was replaced by Fakhruddin Ahmed, a former central-bank governor and World Bank official. The technocratic administration he heads has so far sent the right signals. A drive against corruption—in which Bangladesh regularly nears the top of world league tables—is under way. The national-security chief, the top civil servant in the power ministry and the attorney-general have all been ousted. A start has been made in separating the judiciary from the executive.

But restoring democracy remains a tall order. The political system has collapsed. The army insisted the president step in before the Bangladesh Nationalist Party (BNP), which headed a coalition government for the past five years, could rig the election and secure itself another term.

Delaying the vote averted a possible bloodbath. Allegations of election-rigging levelled by an alliance led by the other big party, the Awami League, had led to weeks of often violent protests and strikes. Their charges were, in effect, backed by foreign observers. Both the European Union and the UN withdrew their support for the election. The UN also warned the army against partisan intervention in politics, adding that this might jeopardise its lucrative role in UN peacekeeping operations. This threat helped sever an alliance between the army and the BNP.

The BNP's leader, the previous prime minister, Khaleda Zia, is reported to have been taken aback by the state of emergency and disappointed in the generals. But the BNP is unlikely to go quietly, raising fears that the administration might be forced to make fuller use of its wide-ranging emergency powers, which it has so far used with restraint.

Unless something extraordinary happens to make the parties behave, there will be no return soon to two-party politics. It will take time to fix a voter list bloated with millions of extra names, to issue voter-identity cards, to set up a new independent election commission, and to purge the bureaucracy. It seems unachievable before the July monsoon, which pushes polls back to the final quarter of 2007. Indeed, what would be the fourth electoral battle between Mrs Zia and the League's Sheikh Hasina Wajed may never happen.

Arguing in favour of the state of emergency, Bangladesh's largest-selling newspaper, *Prothom Alo*, has exposed the practice of parties' auctioning off parliamentary seats for money. Matiur Rahman, the editor, also alleges that both big parties entered a bidding war to lure the Jatiya Party of the former dictator, Hossain Mohammad Ershad, into their alliance. Jatiya has asked the army to shut the paper down.

Although the state of emergency has supporters even among some liberal democrats, it is a high-stakes gamble. Authoritarian rule is unlikely to appeal for long, however fed up voters are with the two big parties and their mutually-loathing leaders. The main beneficiary from the failure of mainstream politics is an extremist Islamist fringe.

Internationally, the stakes are highest for neighbouring India. It accuses Bangladesh of harbouring insurgent groups

from its north-east, and is home, claim politicians, to some 20m Bangladeshi migrants. By 2050 Bangladesh, only twice as big as Ireland, will have about 250m people. In the short term the only voting on offer to Bangladesh's people, half of whom live in abject poverty, is with their feet.

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South-East Asia

Wandering workers

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From The Economist print edition

More and more South-East Asians are leaving home to seek work

Reuters

Moving up in the world

PEOPLE are the Philippines' main export. Last year more than 1m Filipinos left to work abroad as maids, nurses, sailors and in all sorts of other difficult but low-paid jobs. Labour migration is huge, and growing, in South-East Asia, as workers are sucked out of its poorer countries, increasingly to their better-off neighbours, even though these are still themselves sending workers to the rich world.

Many of these wandering wage-earners eventually return. In the meantime they send home huge sums—in the Philippines' case, the equivalent of over 10% of GDP. This compensates for the opportunity cost of having, at any one time, 8m of its best workers abroad. On January 15th the government reported a surge in such remittances. In January-November they were $11.4 billion, up 18% on the same period of 2005, not counting the odd billion that arrives unofficially, as wads of cash in returning workers' luggage. Poverty and unemployment are still high in the Philippines and other labour-exporting countries. They would be far worse but for this outflow of bodies and inflow of dollars. As for those Asian countries that import labour, as in Europe (see article), falling birth rates mean they are going to need more foreign workers, like it or not.

On January 13th leaders of the Association of South-East Asian Nations (ASEAN), meeting in the Philippines, signed an agreement to aid and regulate migrant workers—a sign of their realisation that the flow of labour, often illegal and undocumented, between their countries is a growing problem that they cannot blame on outsiders. A 2005 study reckoned that 8.4m South-East Asians worked outside their home country but this did not include the huge numbers of Indonesians doing so without papers. The study also had just 150,000 Burmese working in Thailand, whereas up to 2m Burmese illegal immigrants are thought to live there. So the true total is probably rather higher.

The new agreement talks of guaranteeing foreign workers access to justice and welfare services though, like other ASEAN documents, it is full of get-out clauses. But it does oblige governments to draw up a charter of migrant workers' rights which might have some teeth. The Philippines is already seeking to improve its own migrants' rights: it plans to ban recruitment agencies from charging fees to workers (as opposed to employers) and is raising the minimum wages that such agencies offer.

Roughly speaking, of the ten ASEAN countries, the Philippines, Indonesia, Myanmar, Cambodia, Vietnam and Laos export labour, Singapore and Brunei import it, and Thailand and Malaysia do both. Gyorgy Sziraczki of the UN's International Labour Organisation (ILO) points out that, in the next ten years, the total labour-force of the worker-exporting countries should grow by about a third—but labour migration, legal and illegal, is growing twice as fast as even that. Tackling the problem before it gets out of control clearly makes sense. But the labour-importing countries are terrified that, with huge numbers of poor people just across their borders, any moves to improve the welfare of their existing immigrant workers and give papers to the illegal ones will only encourage masses more to stream in.

Locals in the receiving countries already seem to be worried about competition for their jobs. In a recent poll for the ILO, 59% of Thais said their government should admit no more foreign workers, and only 10% thought more should come. Even in prosperous, cosmopolitan Singapore, just over half of locals oppose admitting more foreign workers, according to a poll in the *Straits Times*. Opinions might soften if the public got a more balanced picture of the pros and cons of importing labour to do jobs that no local will take. Malaysians think that the increase in foreign workers has worsened crime rates. Official figures show that foreigners in the country commit proportionately fewer crimes than do Malaysians themselves.

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About sponsorship

Taiwan's trade

Playing the other woman

Jan 18th 2007 | TAIPEI
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A missing link in the chain of East Asian free-trade agreements

ONE agreement signed at the summit in the Philippines on January 14th sought to liberalise the trade in services between China and ASEAN. It was another boost for China's regional image—that, said Gloria Macapagal Arroyo, the Philippines' president, with no sense of Orwellian satire—of “a big brother”. But one big Asian economy, excluded from the party, felt anxious: Taiwan.

It joined the WTO in January 2002. Because China bristles at any hint of an independent international identity for the country, it had to use a cumbersome name: “the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu (Chinese Taipei)”. But at least it is a member. Now, however, Taiwan risks renewed isolation. The Doha round of WTO talks has stalled. The Asia-Pacific Economic Co-operation (APEC) forum, to which Taiwan also belongs, has failed to implement a planned APEC-wide free-trade zone. Bilateral free-trade agreements (FTAs) are all the rage.

Taiwan is excluded. It has made great strides in slashing tariffs, removing other barriers to trade and improving its protection of intellectual-property rights. Its foreign trade last year exceeded $420 billion in value, with China its biggest partner. It is the world's 16th-biggest exporter and importer. But none of this matches China's political clout.

The only countries with which Taiwan has FTAs are three from its handful of mostly tiny diplomatic partners—Panama, Nicaragua and Guatemala. China bullies any country thinking of an agreement with Taiwan. This, combined with Taiwan's insistence on calling itself by its proper name, scuppered an FTA with Singapore in 2002, and deterred other ASEAN countries.

Officials now concede that there will be no big bilateral trade deal—eg, with Japan—unless America signs one. But the Bush administration is in no mood to rile China. Taiwan's quest for trade deals with important partners is doomed. Yet it finds it hard to give up the search for formal ties. Before being sure it is impossible to be “a legitimate wife”, says Liao Yao-chung of the government's economic planning council, “who would volunteer to become a mistress?”

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Israel and Syria

Why can't they just make peace?

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From The Economist print edition

Claudio Munoz

A back-channel peace plan between Israel and Syria may be more hype than substance but optimists say it could be a harbinger of negotiations to come

IF ONLY Israel could make peace with Syria, the optimists muse: it could be the key to peace in the whole Middle East. No longer sensing enemies on every side, Syria could relax, stop backing insurgents and radicals in Lebanon, Palestine and Iraq, and join the West in isolating Iran. So the news that broke this week in an Israeli newspaper, *Haaretz*, of a secret back channel that ran for two years and even produced an outline of a possible peace deal, caused quite a stir. Could peace talks still be round the corner?

The sticking point has always been the Golan Heights, which Israel captured from Syria in the war of 1967. Talks dragged on through the 1990s but finally collapsed at Shepherdstown, West Virginia, in 2000. Israel's then prime minister, Ehud Barak, wanted to keep a ten-metre-wide strip of the Golan bordering the Sea of Galilee, to guarantee Israel's control of the source of 40% of its fresh water. Syria's president, Hafez Assad, demanded the right to swim in the lake as he had done in the days when Syrians controlled the eastern shore.

Assad died soon afterwards. Under his son and successor, Bashar, Syria has made repeated overtures. The latest came earlier this month at a conference to mark the 15th anniversary of the Madrid summit that preceded the secret Oslo talks between Israel and the Palestinians. Riad Daoudi, the Syrians' top legal adviser, reiterated that Syria was now ready for talks without preconditions and, according to one participant's rough notes, said that “negotiations mean that we will come to the table with all that we are and all that we have, including our relationships”—ie, that Syria's ties to Iran, Lebanon's Hizbullah and the Palestinian Islamists of Hamas would all be up for discussion.

Both the current and former Israeli prime ministers, Ehud Olmert and Ariel Sharon, have constantly rebuffed Syria's advances. But the Israeli establishment is sharply divided. While the pro-talks camp argues that the potential benefits are worth the risk, the sceptics, a majority, say that Bashar Assad is either too immature or weak to pull off a peace deal or is only pretending to want one in a (vain) attempt to curry favour with the Americans.

Moreover, the debate has grown fiercer since the summer. Israel's war with Hizbullah so destabilised Lebanon that there is talk of another war soon. The spiral into chaos among the Palestinians has made peace with them seem more remote than ever; a visit this week to the region by Condoleezza Rice, the American secretary of state, produced a widely supported but as yet vague commitment to revive the comatose “road map” peace plan. Against this backdrop, talks with Syria look like the only alternative to more fighting.

Hence the hubbub over the back channel. According to *Haaretz*, after Israel rejected a Syrian attempt to create a more formal channel in 2004, Alon Liel, a former ambassador and (briefly) director-general of the Israeli foreign ministry, took matters into his own hands and held eight meetings with Ibrahim Suleiman, a Syrian living in

Washington, DC, with close ties to Mr Assad. A Swiss diplomat mediated. Even Dick Cheney, the American vice-president, was reportedly kept informed.

Their plan is certainly creative: all of the Golan reverts to Syrian sovereignty, but becomes a demilitarised national park that Israelis can enter without visas; Israel's water is safeguarded; and the two countries impose zones of reduced military presence on either side. It does not address several big issues, such as the Syrian refugees from the Golan or the Israelis now living there, but it is progress.

Who gave a nod?

One question is: did the talks have quiet official approval? The Israeli and—despite reports that senior Syrian officials were indirectly involved—the Syrian leaderships have issued strong denials. Mr Liel has stressed that he was not representing the Israeli government, but says he kept it constantly informed, though it is unclear precisely who was in the know. Mr Olmert, who has firmly ruled out peace talks on the ground that America is against them, may have a more immediate reason for denying knowledge of the talks: he would risk being eaten alive by hardliners in his increasingly fragile coalition if he were seen to entertain the idea.

However, neither Mr Liel nor Mr Suleiman is known as a heavyweight in the back-channel world. Another question is why the story was leaked now. Mr Liel says he thinks it time to “pressure” the Israeli government into considering talks with Syria. The only result so far has been to show, more clearly than ever, that while the general shape of a peace deal is quite easy to draw, the hard part is the political will to try it out.

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The Palestinians

It's the little things that make an occupation

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Those seemingly minor inconveniences that make life hellish

DURING 2006, according to B'tselem, an Israeli human-rights group, Israeli forces killed 660 Palestinians, almost half of them innocent bystanders, among them 141 children. In the same period, Palestinians killed 17 Israeli civilians and six soldiers. It is such figures, as well as events like shellings, house demolitions, arrest raids and land expropriations, that make the headlines in the Israeli-Palestinian conflict. What rarely get into the media but make up the staple of Palestinian daily conversation are the countless little restrictions that slow down most people's lives, strangle the economy and provide constant fuel for extremists.

Arbitrariness is one of the most crippling features of these rules. No one can predict how a trip will go. Many of the main West Bank roads, for the sake of the security of Israeli settlers in the West Bank, are off-limits to Palestinian vehicles—only one road connecting the north and south West Bank, for instance, is open to them—and these restrictions change frequently. So do the rules on who can pass the checkpoints that in effect divide the West Bank into a number of semi-connected regions (see map).

A new order due to come into force this week would have banned most West Bankers from riding in cars with Israeli licence plates, and thus from getting lifts from friends and relatives among the 1.6m Palestinians who live as citizens in Israel, as well as from aid workers, journalists and other foreigners. The army decided to suspend the order after protests from human-rights groups that it would give soldiers enormous arbitrary powers—but it has not revoked it.

Large parts of the population of the northern West Bank, and of individual cities like Nablus and Jericho, simply cannot leave their home areas without special permits, which are not always forthcoming. If they can travel, how long they spend waiting at checkpoints, from minutes to hours, depends on the time of day and the humour of the soldiers. Several checkpoints may punctuate a journey between cities that would otherwise be less than an hour's drive apart. These checkpoints move and shift every day, and army jeeps add to the unpredictability and annoyance by stopping and creating ad hoc mobile checkpoints at various spots.

According to the UN's Office for the Co-ordination of Humanitarian Affairs (OCHA), the number of such obstacles had increased to 534 by mid-December from 376 in August 2005, when OCHA and the Israeli army completed a joint count. When Ehud Olmert, the Israeli prime minister, agreed last month to ease restrictions at a few of these checkpoints as a concession to Mahmoud Abbas, the Palestinian president, human-rights people reported that not only did many of the checkpoints go on working as before; near the ones that had eased up, mobile ones were now operating instead, causing worse disruption and pain.

It is sometimes hard to fathom the logic of the checkpoint regime. One route from Ramallah, the Palestinian administrative capital, to Jerusalem, involves a careful inspection of documents, while on another the soldiers—if they are at their posts—just glance at cars' occupants to see if they look Arab. Israeli law strictly forbids Israeli citizens from visiting the main Palestinian cities, but they can drive straight into Ramallah and Hebron without being challenged, while other cities, such as Jericho and Nablus, remain impermeable. In many places the barrier that Israel is building through the West Bank for security purposes (though in Palestinian eyes to grab more land) is monitored with all the care of an international border, while around Jerusalem the army turns a blind eye to hundreds of people who slip through cracks in the wall as part of their daily commute.

Because of the internal travel restrictions, people who want to move from one Palestinian city to another for work or study must register a change of address to make sure they can stay there. But they cannot. Israel's population registry, which issues Palestinian identity cards as well as Israeli ones, has issued almost no new Palestinian cards since the start of the second *intifada* in 2000. And that means no address changes either. This also makes it virtually impossible for Palestinians from abroad to get residency in the occupied territories, which are supposed to be their future state, never mind in Israel.

No-through-roads galore

On top of that, in the past year several thousand Palestinians who had applied for residency in the West Bank and were living there on renewable six-month visitor permits have become illegal residents too, liable to be stopped and deported at any checkpoint, not because of anything they have done but because Israel has stopped renewing permits since Hamas, the Islamist movement, took control of the Palestinian Authority (PA) a year ago. (Israel says it is because the PA isn't handing over the requests.)

Like Israelis, Palestinians who commit a traffic offence on the West Bank's highways have to pay the fine at an Israeli post office or a police station. But in the West Bank the only post offices and police stations are on Israeli settlements that most West Bank Palestinians cannot visit without a rare permit. If they do not pay, however, they lose their driving licences the next time the police stop them. They also get a criminal record—which then makes an Israeli entry permit quite impossible.

Some of the regulations stray into the realm of the absurd. A year ago a military order, for no obvious reason, expanded the list of protected wild plants in the West Bank to include *za'atar* (hyssop), an abundant herb and Palestinian staple. For a while, soldiers at checkpoints confiscated bunches of it from bewildered Palestinians who had merely wanted something to liven up their salads. Lately there have been no reports of *za'atar* confiscation, but, says Michael Sfard, the legal adviser for Yesh Din, another Israeli human-rights body, the order is still in force. As he tells the story, he cannot help laughing. There is not much else to do.

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Egypt

Not too happy

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A sour mood prevails in the Arab world's most populous country

Get article background

IF A surging economy could solve all ills, Egypt might be the brightest spot in an increasingly grim Middle East. Its GDP is growing by 7% a year. Foreign direct investment is up sixfold since 2003. In the year to last June, the value of Egypt's commodity exports, excluding energy, leapt by nearly a half. With a capable team now running economic policy, a gear-shift towards the kind of sustained performance may lift the most populous Arab country, with its 79m-odd people, into mild prosperity.

Yet Egyptians, by and large, are not in a happy mood, not just because new wealth is only slowly trickling down to the country's crowded and grubby streets. The freeing of markets is unmatched by any freeing of Egypt's politics. In fact, freer forms of communication (including satellite TV and the internet) have only made clearer to Egyptians just how unfree they remain.

Reuters

Brothers—and sisters—in opposition

Take the case of Imad Kabir, a 21-year-old Cairo bus driver. Last year, he made the mistake of intervening in a row between his cousin and a policeman. He was arrested and taken to a police station, where officers beat him, then sodomised him with a broomstick. The affair might have passed as unremarked as myriad other routine incidents of police brutality, except that, perhaps inspired by the shaming tactics made infamous by American soldiers in Iraq's Abu Ghraib prison, the officers recorded the fun on a mobile phone. In November, an Egyptian internet enthusiast posted the grainy film on his web log. Similar film clips soon emerged, including one of an unknown woman strapped to a pole slung between two chairs, confessing to murder and pleading for mercy.

Egypt's Ministry of Interior says these are exceptional cases. It has arrested two officers charged with torturing Mr Kabir, and mounted a search for the unknown woman. But in the meantime a judge has sentenced Mr Kabir to three months in prison for “resisting authority”. Police have detained a journalist from the al-Jazeera satellite TV channel, confiscating tapes she had made in preparation for a documentary on human-rights abuse in Egypt.

Or take the less dramatic case of Abul Ela Madi, an engineer. In 1994, he left the Muslim Brotherhood to found his own more moderately Islamist party. Earlier this month, a government committee charged with vetting party applications rejected his fourth application for legal status.

The Brotherhood itself remains illegal, though it is by far Egypt's largest and best-run opposition force. Its 88 MPs won their seats as independents, but since the general election of November 2005 it has come under increasing pressure. After a brief martial-arts demonstration by a few dozen black-clad Brotherhood members at one university last month, which the group's leadership says was unauthorised and ill-judged, police arrested some 153 members, including a top deputy. Last week they arrested five prominent businessmen with close links to the group.

The crackdown suggests a renewed determination by the government to crush the group. President Hosni Mubarak, who usually ignores the Brotherhood, has upped the ante by labelling it “a danger to state security” and initiating a move to reform the constitution so as formally to ban the formation of parties based on religion. In response, the Brotherhood says it may simply declare itself a party. Other opposition groups, such as Mr Madi's, may well follow suit, challenging the regime's right to pick and choose its opponents.

This is unlikely to shake the 78-year-old Mr Mubarak, in power since 1981. But it comes amid a gathering wave of niggling challenges to government control. Despite intimidation by plainclothes thugs, university students have elected parallel free unions after government administrators banned hundreds of candidates from official student representative bodies. Ferment has mounted among professional groups, such as judges, lawyers and teachers. More widely, Egyptians voice rising concern over such issues as dismal state education and health services.

In an apparent attempt to address such worries, Mr Mubarak's party is drumming up support for constitutional changes. In the past, demands for reform have often been silenced by such highly touted tinkering. But to most observers, the 34 proposed amendments to the cumbersome 1971 constitution look much like the move to ban religious parties: more of the same, veiled as progress.

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Iran

A president under fire at home

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Is the country's controversial president in decline?

Get article background

IN THE higher echelons of the Islamic Republic, people may be losing patience with President Mahmoud Ahmadinejad. Informed Iranians do not think he risks losing his job. But plainly he is not as safe as he was. Conservatives in Iran's parliament and press blame his extravagance at home and braggadoccio abroad for Iran's worsening economic malaise and for the unpleasant sense of being ever more squarely in the Americans' firing line.

In recent weeks, the United States has twice seized Iranians in Iraq, sent another aircraft-carrier into the Persian Gulf and armed Iran's Arab neighbours with Patriot missiles. Such moves have been accompanied by a barrage of verbal attacks from top Americans, including the president and his secretaries of state and defence.

Already cock-a-hoop over the defeat of Mr Ahmadinejad's allies in local elections last month, his domestic critics are keen to blame him for the latest round of American sabre-rattling as well as for last month's sanctions resolution passed against Iran in the UN Security Council. It seems that a clutch of senior figures in the regime, perhaps including the supreme leader, Ayatollah Ali Khamenei, have endorsed the criticism.

“Just when the nuclear issue was about to move away from the UN Security Council, the president's fiery speeches have resulted in the adoption of two resolutions,” said *Hamshahri*, a popular newspaper in Tehran, the capital. Such comments mark a departure from last year, when it was deemed unwise to challenge the government's performance on the nuclear issue.

Mr Ahmadinejad's anti-American bluster has also been attacked in light of his recent visit to Latin America, widely viewed as ill-timed and unnecessary. A reformist daily, *Etemaad-e Melli*, called the Venezuelan, Ecuadorean and Nicaraguan presidents, who embraced Iran's president, “left-wing friends, good for coffee-shop discussions but not for setting our security, political and economic priorities”.

During the trip, Mr Ahmadinejad announced he would put $1 billion into an Iranian-Venezuelan fund to help countries “free themselves from the yoke of American imperialism”. That sharpened the more serious criticisms he faces at home over Iran's economic performance.

A recent statement signed by 150 members of parliament imposed conditions on the president in drawing up the budget for the next Iranian year, which starts in late March. The MPs are now calling on him to defend his record before parliament.

It would not be Mr Ahmadinejad's first run-in with deputies who supposedly share many of his own convictions. In late 2005, conservative MPs caused a crisis by rejecting several of the president's nominees for oil minister, the cabinet's most important post. They have since repeatedly questioned his off-the-cuff economic style, which pleases the masses but is disliked by most economists.

A sudden decision last year to raise the minimum wage had to be reversed when it caused job losses and strikes across the country. On his weekly trips to the provinces, the president is in the habit of dishing out government largesse to petitioners for local causes. And parliament has accused the government of favouritism in giving big contracts to the Revolutionary Guards without going to tender.

This lavish and sometimes whimsical spending has pushed up inflation and made Iran more vulnerable to oil-price fluctuations. MPs are increasingly concerned, not least because they face re-election early next year and fear they will be blamed for the country's economic woes.

The president seems to thrive on controversy. But he may be in for an unusually rough few months. Taking his cue from the supreme leader, Mr Ahmadinejad may be well advised to dampen his oratory and submit a prudent budget to parliament. But that is not his usual style.

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Somalia

What next?

Jan 18th 2007 | NAIROBI
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Other African countries must replace Ethiopia's forces soon

Get article background

WITH the backing of Ethiopian forces and American intelligence, government forces have quickly recaptured all of central and southern Somalia's towns, including the capital, Mogadishu. Now the important questions are how many of the defeated Islamists have gone to ground, where they are and what their aims are. Some of their harsher commanders are at large but their support seems, for the moment, to have shrunk. The Americans admit that the three top al-Qaeda men they at first thought they had killed in air strikes last week are still alive, but no one seems to know where they are lurking.

By refusing to negotiate even with the more moderate Islamists, Somalia's newly triumphant government may alienate many Somalis and drive militants who are in hiding back into the arms of al-Qaeda, which previously had very little direct support. Transitional-government ministers sound sour about their lack of popularity in many parts of Mogadishu; but they will have to be more conciliatory if they are to have a chance of governing effectively.

Nonetheless, the transitional government is in a brazen mood. It briefly shut down Mogadishu radio stations for reporting attacks made against Ethiopian troops in the city. The transitional president, Abdullahi Yusuf, has stirred controversy by declaring that Somaliland, the rather well-run northern bit of Somalia that has kept out of the war, will stay part of Somalia forever. This angers most Somalilanders, who in effect seceded from the rest of the country in 1991. However, Mr Yusuf, once the leader of neighbouring Puntland, another semi-autonomous chunk of land to the north-east, may be preparing for an agreement whereby Somaliland would give up disputed bits of its territory in return for independence.

Progress towards replacing Ethiopian troops with peacekeepers under the aegis of the African Union has been patchy, though vital for the transitional government's credibility. The Ethiopians have said that they will leave “within weeks”. Somalia's transitional prime minister, Mohamed Gedi, says he expects troops from Malawi, Nigeria, Senegal, South Africa and Uganda to be on the ground by the end of the month, but that is news to many of them. Nigeria and Senegal have yet to agree to help out; South Africa says it is weighing its options. Yet unless the Ethiopians leave and peacekeepers come in soon, the government's honeymoon could end pretty fast. It is a sad measure of the insouciance with which the world treats Somalia that it has managed to drop out of the headlines in the space of a week.

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Mali

Desert discs

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The political roots of one of Africa's liveliest music festivals

AS A very cold wind swept across the sand dunes in the early hours, the time had come for the last concert of this year's “Festival in the Desert”. It is held annually near Essakane, an oasis some 40 miles (65km) north-west of Timbuktu, the ancient city on the Niger river. Reaching it tests endurance, with miles of impermanent sand tracks to negotiate. The reward is a three-day feast of music that has now become so popular that this year 4,000 people turned up.

It is mainly a celebration of the musical heritage of the Touareg, a fiercely independent nomadic people who live in the area. Their concerts feature electric guitars, loud singing, drumming and swirling flutes, belted out through megaphones. Against this raw, distorted background of noise the dancing is remarkably gracious.

The festival coincides with traditional Touareg celebrations but has a political side too. Since the advent of French colonial rule more than a century ago, the Touareg and their cousins in neighbouring countries have been restricted in their movement and made to feel marginal. They first rebelled against the French in 1894 but were bloodily suppressed. Mali's independence in 1960 changed little.

Another rebellion, in the 1990s, extracted partially fulfilled promises from the Malian government that the Touareg would be better represented in the government and the army. To mark this reconciliation, thousands of weapons were incinerated in Timbuktu in 1996, in a ceremony called “the Flame of Peace”; the music festival is an offshoot of it.

Its chief organiser is Habib Koité, an indefatigable singer and guitarist from western Mali. He closed this year's festival, after local heroes Tinariwen and others from around the world had paid homage to the late mayor of nearby Nyafunké, better known as bluesman Ali Farka Touré, who died last year.

It may be in the middle of the desert, but the festival has pulled in sponsors such as the French-owned mobile-phone firm Orange. Touareg traders badger everyone in sight with endless offers of camel rides, swords and jewellery: a once-a-year chance to get some cash before returning to their harsh, nomadic existence for the rest of the year.

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About sponsorship

Migration

Europe's huddled masses

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EPA

Millions of Europeans are on the move. Does it matter?

ROBERT, the Polish-born head of a group of British removal men, can read and write English easily, unlike his British colleagues who after packing their cardboard boxes label them as “clovs” and “shuse”. Two years ago, when he moved to Britain, Robert lugged heavy loads like them. He still lives worse than they do, in a shabby rented house crammed with compatriots. But the remittances he sends home are paying for his family, a car, a house and—eventually—his own business there.

That dream, of hard work abroad leading to success at home, has inspired millions of people to move across Europe since the collapse of communism—a peacetime migration exceeded only by the upheavals that followed the end of the second world war. But remarkably little is known about the nature of this movement of people one way, and money the other, not least because so much is undocumented or illegal. Now a new report* from the World Bank attempts to fill some gaps and explode some misconceptions.

The first is that the main migration is from the ex-communist world to what used to be called the West, when in fact Russia is the main destination for immigrants, surpassed only by America. That is due partly to ethnic Russians returning to the motherland after the break-up of the Soviet Union, but also to Tajiks, Georgians, Moldovans and other non-Slav citizens of ex-Soviet republics moving to Russia in search of work. In the process, Georgia, for example, lost a fifth of its population in the 14 years from 1989.

The money-flows from migration—around $19 billion annually, the authors estimate—are surprising too. In some countries they matter more than foreign investment. For example, remittances make up more than a quarter of Moldova's GDP—a figure exceeded worldwide only in Haiti and Tonga. For nine ex-communist countries, remittances provide 5% or more of national income. In the region as a whole, three-quarters of the money comes from migrants working in the European Union; about a tenth from those in the former Soviet Union.

The big question is the impact on the home country's development. Optimists think that remittances prop up current accounts and help development. “Whereas aid to governments is often wasted or siphoned off into Swiss bank accounts, migrants' remittances end up directly in poor people's pockets,” says Philippe Legrain (formerly of *The Economist*) in a book† arguing the case for migration.

But pessimists reckon that having the best and brightest working abroad, often in menial jobs, is a dreadful loss. Remittances may also keep currencies artificially high, harming growth. The World Bank's authors think only a third of remittances go on education, savings and business investment. The overall result, they surmise, has been a mild stimulus to growth in the recipient countries, but without a measurable effect on poverty: it is better-off, urban families that tend to send someone abroad, and then reap the benefits.

The final misconception is about what motivates migration. “Everyone thinks it is all about income differentials, but actually it is all about expectations. Even in poor countries we can expect low levels of migration if people think that conditions there will improve,” argues Brice Quillin, one of the report's authors.

From one viewpoint, the huge migration of recent years to western Europe seems unlikely to continue. Populations are declining in all countries (except Albania) in the western half of the post-communist region. That tightens their labour markets and may stimulate migration from farther east. By contrast, populations in the southern states of the former Soviet Union—countries such as Tajikistan—will keep growing until the middle of this century. “If the typical migrant of the 1990s was a Pole moving to Britain, his successor in the next decade may be a Tajik moving to Poland,” says Mr Quillin. Even Turkey, previously a big exporter of workers, now imports migrants.

What really helps putative migrants stay at home is not just higher wages but the prospect of fast, effective reform, bringing better public services and a dependable legal system. Employers in post-communist countries, particularly those outside big cities with a local monopoly in the job market, still treat their employees with remarkable casualness. A sawmill in a small town, for example, may fail to pay wages, and then declare bankruptcy, only to restart under a new name with the same owners, managers and workforce.

The catch is that reform throughout the region is flagging. No country between the Baltic, Black and Adriatic seas can boast a strong reformist government, and with a few exceptions the farther east you go, the worse it gets.

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*Migration and Remittances: Eastern Europe and the Former Soviet Union (World Bank, 2007).

†“Immigrants: Your Country Needs Them”. Little, Brown. £12.99.

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About sponsorship

Immigrants in Russia

Market forces

Jan 18th 2007 | MOSCOW
From The Economist print edition

Russia's sensible and less sensible migration policies

“THEY are throwing us all out,” says Makhmoud from Tajikistan mournfully, as he stands in front of a row of dead dangling piglets at Dorogomilovsky market in Moscow. Under new rules that came into force this week, only 40% of workers at Russia's retail markets are supposed to be foreign, and none should be by April 1st.

Russia's markets offer useful insights into the erratic nature of the country's development. Though bits of Russia are booming, inequality is grotesquely wide, and even in glitzy Moscow many Russians rely on cheap market stalls for their daily needs. Yet because many are staffed by immigrants—mostly from the ex-Soviet states of the Caucasus and Central Asia—they have also become a focus for Russia's increasingly visible ethnic nationalism. A deadly bomb at a Moscow market last August, and a riot soon afterwards in the northern Russian town of Kondopoga, where shops and markets were trashed, have been among the worst eruptions of this anger.

Vladimir Putin's response to Kondopoga vindicated those who think the Kremlin has been too accommodating towards extremism. He denounced the “semi-gangs, some of them ethnic” that controlled Russia's markets, and called for regulation to protect “the native Russian population”. Hence the new rules, which are officially supposed to help Russian farmers get better prices for their produce. But since they affect only the market dogsbodies, rather than the middlemen, they actually seem designed to remove non-Slavic faces from the stalls.

Still, if xenophobia is one influence on Russia's migration policy (and racist murders are running at roughly one a week), there is another contradictory pressure that the Kremlin cannot ignore. Beneath its petrorouble prosperity, Russia is not only angry, but dying: the population is shrinking by around 750,000 per year, a drop mostly driven by the catastrophic rate of death—by violence, heart disease, tuberculosis and, increasingly, AIDS—among working-age men.

If the economy is to diversify beyond its natural-resources core, that is alarming. In response, President Putin has mostly talked about attracting more ethnic Russians back from the other ex-Soviet states, and of boosting the birth rate. But some in the government evidently understand that these measures will not suffice—because this week, sensible new rules that will make it easier for foreigners to work legally in Russia everywhere but in markets were also introduced.

Up to 6m work permits are to be available this year for migrants from the poor ex-Soviet republics. That may be far fewer than the 8m-12m people that the federal migration service estimates are working in Russia illegally, but it amounts to far more than have been handed out before. Moreover, a simpler process should mean less official extortion.

As Elena Tyuryukanova, a migration expert, says, the “right hand of government is liberalising the law, and the left hand is doing the opposite.”

The left hand, however, may yet have to reconsider. This week, as foreign workers—in Siberia and the Far East, mostly Chinese—packed up their market pitches, the government was insisting that the markets stay open, and that prices must not rise.

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Spanish politics

Belated realism

Jan 18th 2007
From The Economist print edition

Mr Zapatero says he's fallible

“I MADE a mistake,” is not a phrase often heard in Spanish politics. But José Luis Rodríguez Zapatero produced it in parliament this week—recognition that things are not going well for Spain's socialist prime minister. Mr Zapatero was regretting his prediction that, in relation to the armed Basque group ETA, “we will be better off in a year's time than we are today”. Those words were spoken the day before ETA broke a nine-month ceasefire, killing two people with a bomb at Madrid's Barajas airport on December 30th.

Already 2007 looks set to be Mr Zapatero's toughest year. Rumours that he will call an early election may be unfounded but are a sign of growing tension. At a bruising parliamentary debate to discuss the ETA bombing, the opposition People's Party (PP) leader, Mariano Rajoy, stuck to his absolute refusal to back peace talks. His party believes Mr Zapatero's desire to negotiate an end to decades of Basque separatist violence is a sign of weakness.

It is also Mr Rajoy's opportunity. If ETA plants more bombs, he will say Mr Zapatero has failed. If there are none, he will say he has caved in to terrorism.

Even before the bombings, some of Mr Zapatero's allies were starting to question his style. The socialist-leaning *El País* newspaper accused him after the bombings of failing to tell Spaniards why he had clung to his optimism. It also reminded him that he had come to power pledging not to negotiate with ETA. “He should have explained his motives for renouncing that,” it said.

All this marks a change of fortune for Mr Zapatero, whose government won election three days after radical Islamist train bombers killed 191 Madrid commuters in March 2004. Early moves, such as troop withdrawal from Iraq and legalising gay marriage, proved genuinely popular.

Now, however, he has run out of easy crowd-pleasers. New charters of self-government for some of Spain's 17 regions will appear, with Andalusia to vote in a referendum next month. They will prove less tricky than last year's Catalan charter, but are no guarantee of votes for Mr Zapatero in a 2008 general election. Nor are measures to protect the environment, modernise public services and boost research and development. Sadly for Mr Zapatero, ETA is set to remain on the front page.

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Bavarian politics

Exit a king

Jan 18th 2007 | BERLIN
From The Economist print edition

Edmund Stoiber leaves the stage

CLINGING to power can be dangerous. Take the case of Ludwig II, the eccentric Bavarian king (1864-86) who built the fairy-tale-style Neuschwanstein castle. Refusing to step down, he was declared insane and later found drowned. Edmund Stoiber, Bavaria's premier, will not end up in Lake Starnberg, but after weeks of drama, even supporters in his Christian Social Union (CSU) were muttering that he must have lost his mind. Had he not promised on January 18th to resign, the result would have been a full-blown mutiny.

King Ludwig's fate inspired romantic films; Mr Stoiber's woes are more a Greek tragedy, in which the protagonist is bound to meet disaster. Premier since 1993, he seemed to be driven by a never-ending quest to be the best and the (false) belief that he was irreplaceable. The 65-year-old workaholic is even known to study the footnotes of reports, never making a decision before having all the information. And in many ways, the results prove his point: Bavaria is one of Germany's most prosperous states, with an unemployment rate of 5.9%, almost four percentage points below the national average.

Yet Mr Stoiber never became a politician for whom voters felt more than just respect. As candidate for chancellor in 2002, he bungled his campaign, not least because of his erratic way of speaking (the verb “stoibering” has entered the German language). Worse, he vacillates. Mr Stoiber was offered, but refused, the jobs of federal president, head of the European Commission and, most recently, “super minister” for economics in Berlin's grand-coalition government of Christian and Social Democrats, or CDU and SPD. This last volte-face, in November 2005, proved especially damaging. He had pushed hard to get the job, weakening the conservative camp during coalition negotiations.

Even so, the CSU (the CDU's sister party in Bavaria) stuck with him: he was, after all, the leader most likely once more to win the party an absolute majority at the state elections in 2008. But as his and the party's ratings kept sinking, the rank and file became restless. Matters grew worse when it emerged last month that Mr Stoiber's right-hand man had tried to dig up dirt on a party leader who was openly calling for Mr Stoiber to go. Mr Stoiber seemed for a moment to have stilled the dissent—but he then dismayed the party by announcing that he planned to hang on until 2013, a full fourth term in office.

Then the situation got out of control, with newspapers full of anonymous quotes from CSU leaders that Mr Stoiber's position was no longer tenable, and with potential successors poised to take over: probably Günther Beckstein, Bavaria's interior minister, as premier and Horst Seehofer, the grand coalition's agriculture minister, as party chairman.

One immediate question is what effect Mr Stoiber's departure will have on the grand coalition. On the one hand, it could be good news for the chancellor, Angela Merkel. Mr Stoiber has often made life difficult for her, most recently by demanding changes to health-care reform. But Mr Seehofer could be an even more difficult partner: sometimes he is more of a Social Democrat than many in the SPD.

The most important issue will be whether Bavarians are sick not just of Mr Stoiber but of the party that has governed them for half a century. If the CSU were to lose its absolute majority, Mrs Merkel might not be re-elected in 2009.

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Albania and Kosovo

What happened to Greater Albania?

Jan 18th 2007 | PRISTINA AND TIRANA
From The Economist print edition

Nationalism is not nationality

Get article background

SOON after Serbia's parliamentary election on January 21st, Martti Ahtisaari, a former Finnish president asked by the United Nations to produce a plan for the future of Kosovo, will present his ideas. Since 1999 Kosovo has been under UN jurisdiction. Technically it is part of Serbia, but 90% of its 2m people are ethnic Albanians who want full independence. Mr Ahtisaari's plan will suggest that Kosovo becomes independent, but only with conditions. One is clear: Kosovo will unite neither with Albania nor with Albanian-inhabited parts of Macedonia.

In the 1990s, when the old Yugoslavia collapsed in blood, Serbs and Croats tried to carve out a Greater Serbia and a Greater Croatia. Many Serbs feel that it is thus only a matter of time before Albanians seek a Greater Albania. Yet neither in Kosovo nor in Albania have politicians advocating union ever made headway. A poll in Kosovo in 2005 found that whereas more than 90% backed independence, fewer than 10% wanted union with Albania. This points to a conclusion that Albanian nationalists hate: younger Albanians in Kosovo have developed a Kosovar identity of their own. It is not that they do not feel Albanian; rather that they see no contradiction in feeling Kosovar as well.

Over the next few months this debate will intensify, not least because Kosovo will need a flag. Today Kosovo Albanians use Albania's; but if Kosovo becomes independent, it will need its own. Prominent in the discussion will be Migjen Kelmendi, who edits a paper written in Kosovo's Albanian dialect, as opposed to the standard literary form. He says that when Kosovo was oppressed by Serbia, “I had to identify with Albanianism.” Now, he feels proud about being a Kosovar as well.

The difference between Serbs and Croats on the one hand, and Albanians on the other, is that most Serbs and Croats lived in one country until 1991. Since the end of Ottoman rule in 1912 Albanians never have, and so they have grown apart. Politicians in Albania have never shown much interest in their kinsmen outside the country. With independence in sight, Kosovo's leaders have no intention of submerging their new state into another.

Albanian nationalists generally dislike the term “Greater Albania”, preferring to talk about “ethnic Albania”. This covers not just Albania, Kosovo and western Macedonia, but parts of Serbia and Montenegro too. Few Albanians, however, are interested in fashioning a new state out of this land. For most, joining the European Union is a far more pressing concern.

In any case, especially between Kosovo and Macedonia, a quarter of whose 2m people are Albanians, politicians and academics, students, businessmen—and criminals—all move around as if they lived in one country. A Macedonian Albanian, Teuta Arifi, argues that Albanians should emulate German-speakers, who have built separate identities in Germany, Switzerland and Austria while continuing to belong to the same German culture.

A pan-Albanian market of 6m consumers, is slowly emerging. But in terms of business there is some way to go. In 2005 Kosovo's exports to Albania were a mere €5.2m ($6.5m), and Albania did not even rank among its top ten importers.

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Charlemagne

Not normal

Jan 18th 2007
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Peter Schrank

The European Parliament has yet to fill the democratic deficit

THIS week a conservative took over from a socialist as president of the European Parliament and many of its committees changed hands. If this were a normal parliament, presumably there would have been a fiercely contested election or some other basic political shift. In practice, the changes represent Buggins's turn: halfway through the European Parliament's five-year term, the top jobs are shuffled to give someone else a go. There has been no discernible shift in popular opinion and the choice of Hans-Gert Pöttering as president was a foregone conclusion. Clearly, the European Parliament is not a normal parliament.

That is not entirely a criticism. It is, after all, the only directly elected international parliament in the world with any authority. It is also an attempt to reconcile, says Nick Clegg, a former MEP and now a Liberal Democrat MP in Britain's House of Commons, “one of the greatest dilemmas in contemporary politics: the mismatch between the resilience of national political loyalties and the reality of supranational political challenges, such as migration and the environment.”

So you might expect it to be an odd beast—and you will not be disappointed. The European Parliament contains 189 national parties. It may not propose, but only scrutinise, most legislation. It has virtually no powers in the areas you might think most important, such as migration. Unlike elsewhere, uncompleted laws do not lapse when its term ends, but simply resurface next time around. Two-thirds of votes are taken by a show of hands, producing North Korean-style majorities of 80% and more. And the parliament—to no discernible purpose other than French national pride—continues its habit of migrating from Brussels to an expensive building in Strasbourg for four days a month.

Considering these oddities, the parliament has done a good job of making itself useful. Ten years ago, it was regarded as a joke or an embarrassment. But in 2006 it was responsible for hammering out the final compromises on the two most important items of legislation to come out of the European Union for a long time: the directive liberalising services and legislation regulating chemicals. Both had been debated for years; neither the European Commission (the EU's administration) nor national governments had been able to do the necessary deal.

As a result, Europe's parliament is starting to feel a bit more normal. It used to be full either of old buffers retiring gracefully into the expense-account restaurants of Brussels and Strasbourg or young politicians killing time before starting their real careers at home. Now a generation of middle-aged, middle-ranking politicians are coming through who have made the parliament their life's work. Being an MEP is more like a real job.

In parallel, there are signs, albeit somewhat patchy ones, that pan-European political groups are emerging as genuine political actors. Rules passed in 2004 have encouraged formal cross-party parliamentary groups, such as the European People's Party of the centre-right, the Party of European Socialists and the European Green Party. These are not parties in a conventional sense, but ideologically coherent bodies that cut across national boundaries and make the parliament look more like a traditional forum in which left, right and centre slug it out.

Parliamentary groups are even forming at the extremes, traditionally beyond the pale in most European assemblies—witness the recent creation of a group of far-right parties. Arguably, the parliament has adapted better to the EU's

enlargement than other European institutions have; it is certainly the one place where Europhobes and rabid nationalists (who, like it or not, embody strands of public opinion) get a hearing.

But if the parliament is becoming a more effective bureaucracy, that was not its primary purpose, which was—or should be—to increase the union's popular legitimacy. It may look more like a real parliament. But it is not yet one. It is merely an improved imitation.

An ear for the voters?

Perhaps it is unfair to criticise the parliament for what are really democratic failings in the EU as a whole. The union has never relied on representative institutions to win legitimacy, preferring instead to think the process of integration itself would win popular support. But that support is ebbing. The European Parliament is the only directly elected EU institution—and so the obvious candidate for making the union more accountable to its citizens. Unfortunately, it is making a lousy job of the task. For example, when French and Dutch MEPs voted overwhelmingly for the European constitution, they were acting more as an integrationist lobby than as representatives of their constituents. No wonder turnout has fallen in every European election, while almost everywhere the gap between higher turnouts in national races and lower ones in the European races has grown.

But the parliament is more a symptom than a cause of the EU's “democratic deficit”. In a normal democracy politicians set out their stalls by making electoral promises. Voters choose a parliament to pass laws and a government to administer policy. Policies are supposed to reflect voters' choices. If they do not, government and parliament are held accountable at the next election. Compare that with the practice of the European Parliament. Except for the Greens, no party issues a pan-Europe manifesto. There is therefore no mandate to speak of. There is no EU government for parliament to hold accountable. And there is no connection between policy and voters' choices.

The result is a paradox: the European Parliament is more important bureaucratically but in a democratic sense remains frivolous. Logically, the EU ought either to increase its powers (for example, by enhancing its role in choosing the commission and its president) or it should cut them back. In the long run the current arrangement—increased influence, but not popular support—is not likely to be sustainable.

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Britain and India

Chasing an elephant

Jan 18th 2007
From The Economist print edition

Bridgeman

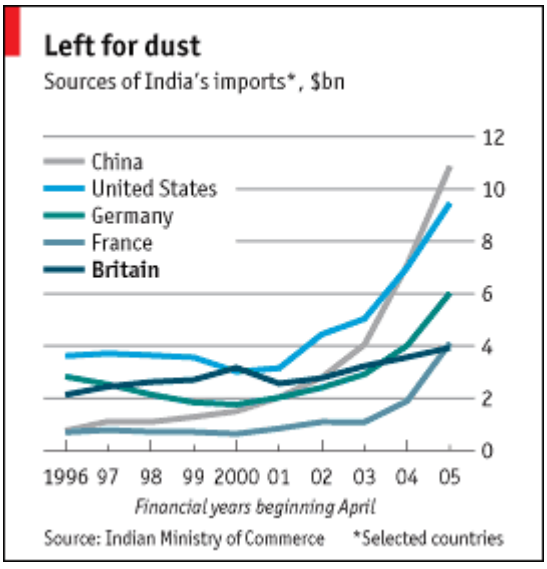
Britain hopes to profit from its old ties with India. Thus far it has been disappointed

IN BETWEEN games of croquet, members of Britain's imperial governing class spent much of their time worrying about what would happen if they lost India. With the resources of such a giant country at her disposal, Britannia bestrode the world. Without them, she would be nothing more than a medium-sized European power with a healthy economy, a widely spoken language and a talent for inventing sports with arcane rules. A version of that old imperial anxiety is playing itself out again, albeit with the balance of power up-ended by globalisation. With this in mind Gordon Brown, the chancellor, made his first visit to India this week.

For British politicians and businesses, the economic rise of the world's second most populous nation ought to be an opportunity to make history count for something. Britain has plenty of successful, dynamic immigrants from India who provide a good link to the country they left behind. India's elite speaks impeccable English and likes to spend summers in London. What could go wrong?

And yet while India is keeping its part of the deal, growing at 8% a year, Britain has thus far been slow to profit. A report by the House of Commons select committee on trade and industry recently declared that British business had been left behind. Exports have grown slowly compared with those from other big economies (see chart): a baffling mixture of scrap metal and pearls has constituted almost two-thirds of Britain's sales to India recently, the select committee found. British firms have also been unadventurous investors. Just 0.5% of their foreign direct investment has gone to India in the past few years, although India's share picked up in 2005.

To lose India twice would be careless, and the government knows it. The canapé-makers in the British High Commission in Delhi are working overtime to prevent it. Alistair Darling, the secretary for trade and industry, went to India this week too, taking over 100 British businessmen with him. Other visitors from the cabinet in the past few months include Margaret Beckett, the foreign secretary, and David Miliband, the environment secretary. More junior types drop by every few weeks.



Mr Brown was unlucky with his timing. Indian newspapers were mainly interested in the plight of Shilpa Shetty, an Indian film star who swapped the big screen for “Celebrity Big Brother”, a British reality-television show. Miss Shetty was bullied by her fellow celebrities for being Asian, prompting effigy-burning in India. The show's British sponsor suspended its support, but the incident was an unhelpful warm-up for a chancellor stressing the cultural ties and shared values that bind the two countries together. The links between Britain and India are real enough, though.

Indians began arriving in Britain in large numbers shortly after their country gained its independence in 1947. More than 60,000 came before 1955, about a fifth of whom were whites

born in India. This first generation drove buses and worked in foundries and textile factories. Their children moved into white-collar jobs. Later arrivals opened corner shops or ran post offices. The flow peaked between 1965 and 1974, boosted by Idi Amin's decision to expel some 90,000 Gujarati Indians from Uganda, after an angel had told him to do so in a dream. Of the 1m people in England and Wales who described themselves as Asian British (Indian) in the 2001 census, most were born in Britain.

They are a conspicuously successful bunch. The most recent survey of what 18- year-olds are up to in Britain could not find enough unemployed Indians to constitute a meaningful sample. Those who have arrived in the past few years have entered the labour market right at the top. Indians have been granted over three times as many visas for highly skilled migrants as any other nationality since the Home Office invented the category in 2002. They are prominent in public life too. Though fairly few have been elected to Parliament, there are plenty in the House of Lords. And they also prop up political parties: this week Lakshmi Mittal who, appropriately for Britain's richest man is named after the Hindu god of wealth, helped the hard-up Labour Party by giving it £2m ($3.9m).

Given this pool of talent, Britain's relative sloth is surprising. “The problem”, says (Lord) Kumar Bhattacharya, scion of an Indian tea dynasty and founder of the Warwick Manufacturing Group at Warwick University, “is that people just assumed Britain would outsource lots of menial jobs to India and move up the value chain. That was patronising.” Some say British firms overestimated the difficulties of doing business in India. And they are hindered by protectionism in the service industries where the British are strong. Foreign banks face restrictions; foreign law firms are banned. Until that changes, and there are signs that it may, Britain's trade deficit with India is likely to grow.

That said, Britain is profiting from India in other ways. It was the second-largest foreign investor in Britain in the first half of last year. Tata Consultancy Services, one of the largest Indian investors, employs more than 2,000 people in Britain. The government thinks there are 23 Indian companies listed on the London Stock Exchange, more than on the New York Stock Exchange and NASDAQ combined.

Sir Gulam Noon, founder of a ready-meal business, and (Lord) Kiran Bilimoria, who set up Cobra beer, are confident that British businesses will do better in India. But Britain may have to get used to the idea that, despite all the shared history, as India grows the relationship between the two will become increasingly one-sided.

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Scottish nationalism

To think again

Jan 18th 2007 | EDINBURGH
From The Economist print edition

The Scots are less keen on going it alone than some polls suggest

Get article background

TO HEAR some tell it, Scotland is about to celebrate three centuries of union with England and Wales by breaking away from Great Britain. A flurry of opinion polls appear to show that a majority will vote for the Scottish National Party (SNP) in May's elections to the devolved Scottish Parliament. Then would come a referendum on independence, which the SNP advocates, and farewell to 300 years of history. Mulling it all over this week, the Scots marked, in conspicuously muted manner, the anniversary of the original decision to throw in their lot with their southern neighbours.

A careful reading of the polls, however, suggests that the Scots are a long way from walking out. Speculation that they might began with an ICM poll for the *Scotsman* newspaper last October. It found that 51% would vote for independence in a referendum and only 39% would oppose it. In other polls, similarly-phrased questions have given similar answers. Small wonder that Gordon Brown, chancellor of the exchequer, a Scottish MP, and the man most likely to replace Tony Blair as prime minister, has been sounding off on the dire consequences of breaking up.

But other pollsters asking differently worded questions get different answers. A YouGov poll for Channel 4 earlier this month, for example, found that only 40% of Scots would support independence and 44% were opposed. Then they were given further choices that were more specific. When asked how keen they were on a “completely separate state”, only 31% were enthusiastic, whereas 51% supported some variety of devolution, perhaps with different powers, for the existing Parliament.

The word “separate” will be widely hawked around by the SNP's opponents as the election draws nearer. There is reason to think that reactions to it provide a reasonably accurate guide to what Scots truly think about freedom. John Curtice, for one, a psephologist at Strathclyde University, believes that “Scots are no more and no less in favour of independence than eight years ago when the Scottish Parliament was created.”

Still, the SNP does seem to be doing well. Five of the past six polls have given them a lead over Labour, who now govern Scotland in coalition with the Liberal Democrats. Mr Curtice reckons this lead, which has grown from two to six points since October, would net the SNP between 40 and 45 seats in the 129-seat Parliament. If so, they could run Scotland only in coalition.

Even if other parties, such as the Greens, who favour independence won perhaps ten seats, the nationalists would still fall short of the 65 votes needed to get a referendum bill passed. So although the battering that all this implies for Mr Brown's Scottish Labour electoral base is bad news for him, at least it is unlikely that he will need a new passport.

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Inflation

Bad timing

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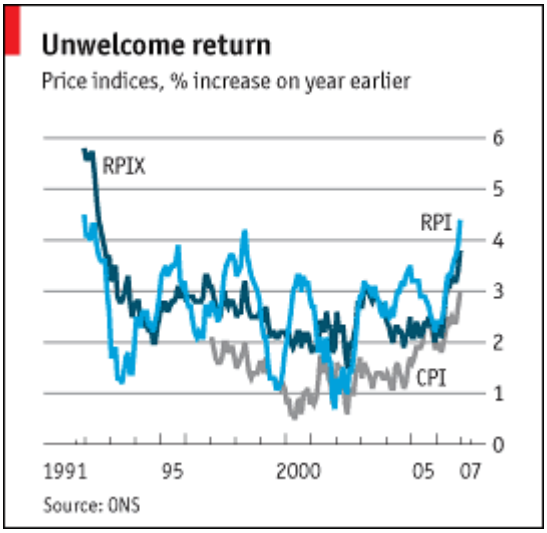
Now the worry is that higher pay deals may cause higher inflation to persist



ON JANUARY 11th the Bank of England shocked the City when it raised the base rate from 5.0% to 5.25%. This week it became clear why the bank's rate-setters made their surprise move. The nine-strong monetary-policy committee had seen an advance estimate of consumer prices, which rose by 3.0% in the year to December. This is the highest rate of increase since the official series began in 1997.

Seldom have inflation figures—published on January 16th—been more eagerly awaited. If the outcome had been a touch higher at 3.1%, Mervyn King, the bank's governor, would have had to write to Gordon Brown explaining why. When the chancellor of the exchequer gave the bank control over interest rates in 1997, he stipulated such an open letter if inflation diverged by more than a percentage point from the target, currently 2.0%.

It is a tribute to the remarkable stability of inflation in the past decade that no governor has yet had to put pen to paper. But on the measure previously used for the target, Mr King's blushes would not have been spared. Until the end of 2003 the bank was instructed to keep inflation at 2.5% for retail prices excluding mortgage-interest payments. Defined this way, inflation in December was 3.8%—an overrun easily big enough to have triggered a letter.

A bigger concern for Mr King than these epistolary near-misses is what happened to the broader retail-prices index (RPI), which includes mortgage-interest payments. Measured this way, annual inflation jumped from 3.9% in November to 4.4% last month, the highest for 15 years and double the rate in December 2005.

This is a worry for the bank because the public regards the RPI as a more credible measure of inflation than the consumer-prices index (CPI). First, it has the advantage of familiarity, since it dates back to the late 1940s. Second, it covers council tax and owner-occupier housing costs, which are excluded from the CPI. In principle, the CPI—a series devised to be compatible across the European Union—should incorporate housing expenses, but this has been delayed as European statisticians work out how to do this.

The RPI's credibility is likely to be further enhanced by an initiative designed to counter a widespread lack of public trust in the official inflation figures. On January 15th the Office for National Statistics launched a web-based "personal inflation calculator". This allows people to work out how their own inflation rate may vary from the official average because of differences in their spending patterns. For example, a renter who lashes out on electronics will currently have a lower rate whereas an owner-occupier with a big mortgage loan will have a higher one. Significantly, the statistical office chose the RPI rather than the CPI for the calculator.

The bank's main headache is that the current bout of high RPI inflation is coinciding with a crucial period for wage negotiations. Nearly two-thirds of this year's pay deals will be hammered out in the first four months, mostly in January and April. The RPI measure of inflation is usually used as the benchmark in these negotiations. The danger is that the agreements will reflect current rates of high inflation, which will then entrench them in a classic "price-wages" upward spiral.

Average earnings in the three months to November grew by 4.1% compared with the same period in 2005. That growth is comfortably below 4.5%, when the bank gets worried. The figures record what has been going on rather than what is about to happen, however. The first pay deals of the year, covering a fifth of the employees who settle in January, suggest grounds for concern. According to Incomes Data Services, the typical increase was 4%, sharply up on the previous 3% level. If sustained, this would jolt earnings growth above 4.5%; "pay drift" means that total earnings, which also include bonuses and overtime, tend to increase faster than basic pay.

The outcome of wage negotiations over the next few months will thus determine what happens to inflation. If demands for higher pay can be contained, then inflation should retreat in the middle of the year as lower wholesale

oil and gas prices eventually bring down domestic energy costs. But if wages do move ahead decisively, then it will be harder for the bank to put inflation back into the cage, and it will have to yank up interest rates again.

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Death of the record store

Facing the music

Jan 18th 2007
From The Economist print edition

Britain's music stores are being squeezed off the high street

WHEN Sony Music became the largest record label to start selling music online in 1997, hoping to ape Amazon's success with books, most pundits (this newspaper included) smugly argued that it was likely to end in tears (see article). Book stores, it was said, were dying because they could not compete with Amazon's millions of titles. But customers would stay loyal to music shops because buying online would deprive them of the joy of browsing the aisles and impressing dauntingly hip sales staff with their insights into obscure acts.

Almost a decade later new book stores are popping up across Britain, while record stores are in danger of dying out. On January 11th HMV, Britain's biggest music retailer, posted a first-half loss. Music Zone, whose 104 shops specialise in cut-price CDs and DVDs, went into administration on January 3rd. Virgin Megastores, some of whose stores occupy the choicest spots in British retailing, said that Christmas music sales had fallen from a year earlier.

Smaller independents are faring no better. Mike Caddick, who has owned Swordfish Records in central Birmingham since 1979, says that a couple of years ago his city had at least seven independent record shops. Now his is one of only two.

The assault has come on two fronts. Supermarkets have been selling music aggressively in the past five years. TNS, a research firm, reckons they now account for more than a quarter of all sales. Most stock no more than the 100 bestsellers, but according to the British Phonographic Industry these titles make up about a third of the country's total album sales.

By concentrating on the fastest-moving stock, supermarkets have been able to drive down prices, turning music retailing into a high-volume, low-margin business. This has rippled through the industry, forcing record stores to cut their prices in turn. TNS reckons that the average price of an album has dropped by 16% from £11.25 ($22.10) in 2000 to £9.41 last year.

Music stores have tried to compensate by trimming their selection and promoting DVDs, on which they make more profit. But that seems only to have compounded their problems. Dan Cryan of Screen Digest, a firm of analysts, says the promotion of DVDs in music stores may have hastened the decline in album sales. But DVD sales are falling too, largely because viewers over the age of six get bored watching the same movie repeatedly and more films are available on television.

The second threat to high-street music shops is the internet, which has made copying and stealing music easier but also allowed consumers to sample (legally) a wider choice of albums than even the biggest music stores stock. Online retailers such as Amazon have more than doubled their share of music sales to about 11% over the past five years. Legal download services, including Apple's iTunes, account for less than 3% of the market, according to Verdict, a research firm, but their share may quadruple over the next five years. Music lends itself to internet selling, says Nick Harrison of Mercer Management Consulting, because the customer either knows what he is after (and can order online) or else wants to browse a large range, which may not exist on the high street.

But the dwindling profitability of music shops may ultimately limit that range. Peter Quicke, the managing director of Ninja Tune, a niche recording label, says stock-trimming by high-street stores is forcing firms to produce fewer albums and cut what they spend promoting new acts.

“For the consumer to be able to find anything and everything, shop-front or not, the product needs to be out there and people need to know it exists,” says Hector Dewar of Defected Records, an independent dance label. “Try asking the sales assistant in Tesco for his opinion on the latest music trends.” The greatest losers may be small recording companies, and those who love their music.

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Privacy

Information overlord

Jan 18th 2007
From The Economist print edition

The public wakes up to the surveillance society

VISITORS to Britain often remark on the proliferation of closed-circuit television cameras, as well as on the fact that Britons, by and large, accept them without qualms. A similar indifference greets the warnings of Britain's few civil-liberties campaigners that it is the development of extensive government and commercial databases—less visible, and so less noticeable—that is truly worrying. Britain leads the world here, too. Its police-run DNA database is the biggest anywhere; the government has plans to track and monitor all 11.7m children in the country; and a scheme for a £5.4 billion system of national-identity cards is under way.

Over the past few days, however, the issue has achieved an unusual prominence. On January 15th the government said it was thinking of reforming “overzealous” data-protection rules to allow ministries to share information about citizens more freely. The idea provoked a storm of hostile coverage, with accusations of sinister “super-databases” and “snooping”.

At first sight, it is hard to see what the fuss is about. The government points out that it is not proposing to collect any more data than it already does, merely to circulate existing information more freely. It dismisses talk of a new database as nonsense, and argues that making its officials better informed will improve its ability to govern—allowing them to inform people of benefits to which they did not know they were entitled, for instance. Data-sharing might make it easier for citizens to interact with the state as well. John Hutton, the secretary for work and pensions, tells the story of one family that had to make 44 phone calls to inform officialdom of a death. Sharing information would reduce that number.

Such explanations cut little ice with privacy campaigners. They argue that Mr Hutton's example of the bereaved family is spurious, since most information about dead people is not protected anyway: civil servants had no reason not to pass on the original message. “This government is using incompetence as a justification for extending its powers,” says Gareth Crossman of Liberty, a civil-rights group. He thinks the true motive is to let civil servants trawl speculatively through various official databases looking for discrepancies that might identify benefit cheats or tax dodgers. Others cite the government's patchy record on civil liberties in general (detention of terrorist suspects without trial, the criminalising of nuisance behaviour and keeping DNA samples from suspects who have not even been charged with a crime, for example) as reason enough to suspect sinister motives.

There are practical reasons to worry as well. Whatever the government says, linking lots of small databases is functionally similar to creating a central, master database. Besides, efficiency is not always a good thing: a system that shares information efficiently will propagate errors with the same effectiveness.

Some civil libertarians see hostility to the latest proposals as evidence that the public may, at last, be starting to wake up. They point to polls suggesting that support for the identity-card scheme is falling too. The government's current demeanour is noticeably humble, with promises to consult “citizens' panels” (ie, focus groups) before any change is made and assurances on national radio that talk of a “Big Brother state” is alarmist.

Others worry that public interest in the matter comes too late. In November last year Richard Thomas, the information regulator, remarked that arguing about the pros and cons of becoming a “surveillance society” was pointless; Britons were living in one already.

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School-leaving age

Staying on

Jan 18th 2007
From The Economist print edition

The best days of their lives will soon drag on a bit longer

Get article background

IF THERE is one lesson to be learnt from Alan Johnson, the education secretary, it is surely that qualifications are not everything. He left school at 15 with none at all and got a job in a supermarket stacking shelves. At 18, already married with two children, he became a postman. But after a career as a union official he was elected to Parliament, and in 2006 he took over the education brief.

Like many people without them, Mr Johnson has great respect for qualifications and would like today's youngsters to get more of them than he did. His department is working on plans to keep all young people in education or training until 18, in what would be the first increase in the compulsory-schooling age since it went up from 15 to 16 in 1973.

Critics say that extending compulsory education would simply be compounding failure. Many teenagers drop out because they left primary school unable to read and do sums, and never caught up. What matters is improving early education, some maintain. This is unarguable, but in the meantime compulsion at a later stage could also play a part.

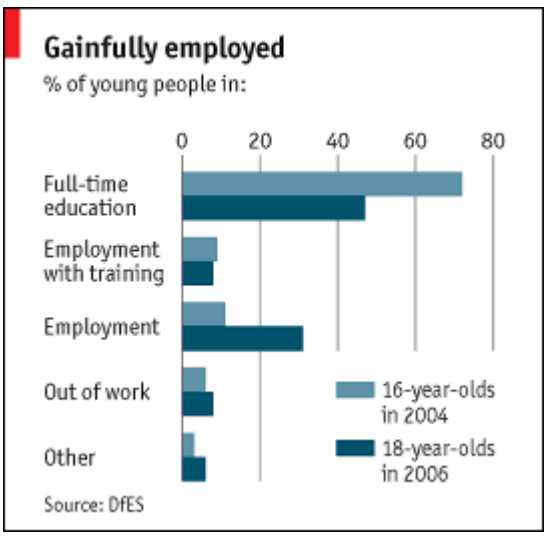
Without the option of dropping out, more young people than you might think will just heave a sigh and knuckle down to their studies. In 1998 pupils who turned 16 before Easter were, for the first time, forced to stay on for the summer term. Researchers at the University of Essex found that quite a few of those who would otherwise have left passed exams that summer—showing that not all of them had been on course for failure.

Around 80% of 16-year-olds now stay in full-time academic or vocational education, or go on a government-financed training course. Another 10% are doing jobs that involve no training; white young men are more likely than any other group to go down this route. If 16-year-olds have to keep studying, most will choose the new vocational qualifications that the education department is developing. Or they may join the 9% of 16-year-olds who are now on apprenticeships and other employer-led training courses.

The government thinks the toughest cases will be the youngsters it terms “NEET”—not in education, employment or training. Another 7% of 16-year-olds fall into this category and the proportion rises to 13% among 18-year-olds (see chart). Those most likely to be unoccupied have many of the characteristics a jaded right-winger might expect: few or no qualifications, a history of truanting and school exclusion, unemployed parents, a background of living with a partner or in care. Around a third of the 18-year-old girls have children of their own.

But there is reason to think that if they had to be in school or training, they would be. Only 1% of young people are unoccupied for more than a year between 16 and 18. And a surprising number of NEETs do not fit the stereotype. A quarter have none of the characteristics above, and quite a few did perfectly well in school while they were there.

It seems many of these layabouts just haven't decided what they want to do in life, and are hanging around waiting for inspiration to strike. They are unlikely to be much of a problem to anyone but their long-suffering parents—who might be glad to have the government's backing when trying to get their offspring out of bed in the morning.



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Ethical retailing

Marketing anxiety

Jan 18th 2007
From The Economist print edition

Choosing green products is one thing, green retailers another

STUART ROSE, the chief executive of Marks & Spencer, is no slouch at spotting new trends. In less than three years he has transformed Britain's biggest clothier from a fuddy-duddy purveyor of black socks and cashmere sweaters into a nimble retailer of fast-moving fashions. The latest rage is ethical consumerism, which is based on the notion that customers can save the planet with their shopping trolleys.

On January 15th M&S said it planned to spend as much as £200m on becoming more environmentally friendly. It will cut emissions of carbon dioxide by saving power and using renewable energy, with a view to becoming carbon neutral by 2012. It will also sell more healthy products and source more clothing and food from Fairtrade suppliers, who guarantee a “fair” price to producers in the developing world. Most British supermarkets have gone green to some extent, but the scale of M&S's initiative dwarfs all that has come before.

What seems to be fluffy do-goodism is underpinned by a hard-nosed identification of two important trends. The first is that Britain's wealthier shoppers are growing more fretful about the effect of what they eat on their health. IGD, a grocery-industry think-tank, found in a survey last year that one-third of shoppers, up from a quarter three years earlier, now choose one product over another if its label has a fuller listing of the ingredients.

M&S has pandered to this shift more than most of its rivals: for some time it has been cutting artificial additives and salt from its meals, stocking its aisles with crisp, bright organic fruit and vegetables. It brands the healthiest third of its food with a colourful “eat well” logo. That helped to boost food sales by 10% in the third quarter of last year.

The second trend is ethical buying. TNS, a research firm, says a quarter of British shoppers claim to be willing to pay more for clothing that comes from firms that pay their employees fair wages or protect the environment. Those good intentions do not dissipate before shoppers reach the tills. Mintel, another research firm, reckons that a third of Britons now buy Fairtrade foods when these are available: sales more than trebled between 2002 and 2006, despite Fairtrade's generally higher prices. When M&S first introduced a limited Fairtrade line last year it reportedly priced its women's denims at about £35, four times the price of their cheapest non-Fairtrade version.

M&S is betting that its £200m investment in greenery will generate enough new sales to pay for itself. One industry expert calculates that it would have to produce £1 billion in extra revenues to meet that target. But the retailer's gamble is based on two unproven assumptions.

The first is that customers who are prepared to pay a premium for what they think is healthy—a selfish and immediate benefit—will also be willing to pay one for something less personal and more remote, such as reducing climate change. The second is that those who salve their consciences over third-world poverty by buying the occasional T-shirt will also be willing to pay over the odds for a supply of ordinary knickers.

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Bagehot

UKIP if you want to

Jan 18th 2007
From The Economist print edition

Steve O'Brien

David Cameron should not lose much sleep over defections to the UK Independence Party

Get article background

BEFORE David Cameron took over the leadership of the Conservative Party, he frequently pondered whether he might be able to engineer what he called a “Clause IV moment”. The special conference to change the party's constitution that Tony Blair held soon after becoming Labour's leader was seen as a defining act that signalled to the electorate the birth of New Labour. Mr Cameron concluded that, sadly, there could be no equivalent for the Tories. Unlike Labour, they did not have an obsolete ideology to junk. Now it's beginning to look as if he may have stumbled on a Clause IV moment of his own after all.

A month before Christmas, Mr Cameron endorsed the view of the *Guardian* commentator and anti-poverty campaigner Polly Toynbee that society is like a caravan crossing the desert: it will fall apart if it leaves behind its weakest and most vulnerable members. Mr Cameron was making the point that poverty is a relative as well as an absolute concept, and that if the gap between the poor and the affluent middle becomes too wide society itself is the loser.

In doing so, he managed to offend traditional Tories in several ways. He appeared to be questioning a core belief of Thatcherite conservatism—that a rising economic tide lifts all boats. And by identifying himself with Ms Toynbee, long a favourite hate figure for the right, he was being provocative. Frank Luntz, a celebrity pollster whose focus group interviews on television helped propel Mr Cameron to the leadership, observed that while he was right to court floating voters, he was alienating the Conservative base and could be “one poorly conceived stunt away from disaster”.

Disaster may be putting it too strongly, but there is certainly danger. Much though old Labour diehards disliked the direction in which Mr Blair took their party, in 1997 they had nowhere else to go. The same is not true of their Tory counterparts today. They are being actively wooed by the anti-European UK Independence Party (UKIP). On the day that Mr Cameron made common cause with Ms Toynbee, Nigel Farage, UKIP's cocky new leader, sent him a lavish floral tribute. The card thanked “Dave” for his “truly exceptional” recruiting efforts on UKIP's behalf.

Until now, UKIP's threat has seemed pretty hollow. It does have a band of MEPs. But distracted by the splits and rows that followed the recruitment and rapid ejection of Robert Kilroy-Silk, a permatanned former chat-show host, it failed to make much mark at the last election, securing less than 2.5% of the votes cast. Michael Howard, Mr Cameron's predecessor, dismissed UKIP's supporters as “cranks and gadflies”. Mr Cameron has gone further, calling them “fruitcakes” and “closet racists”.

Unfortunately, it's a tactic that appears not to be working very well. In December the influential website for Tory activists, ConservativeHome, carried out a survey of its 1,000-strong “members' panel” to find out which other

parties were closest to their views. “None” was the loyal reply of 31%, but 43% chose UKIP. The next-highest party, the Liberal Democrats, scored 7%. Since the new year, there has also been a trickle of highish-profile defections to UKIP.

Two peers, Lord Pearson of Rannoch, a prominent Tory fund-raiser, and Lord Willoughby de Broke, left for UKIP, complaining that Mr Cameron was soft on Europe. Last week, Tim Congdon, an influential economist and former Thatcherite outrider, also announced he would be voting UKIP “unless the Tories drop Mr Cameron and all his misguided baggage (a badly rationalised environmentalism, third world do-goodism, holier-than-thou ‘social inclusiveness’ and the rest)”. Ominously, Mr Congdon made only passing reference to Europe and praised UKIP's efforts to develop a broader policy base.

Perhaps more worrying still for Mr Cameron were the rumblings from Stuart Wheeler, a spread-betting tycoon who once gave £5m ($9.8m) to the Tories, and Sir Stanley Kalms, the founder of Dixons, a high-street electrical retailer. They said Mr Cameron was pushing them and their chequebooks towards UKIP. Meanwhile, at least six Tory MPs have signed up to the Better Off Out [of Europe] campaign, winning a promise from UKIP not to run candidates against them at the next election.

How seriously should Mr Cameron take all this? Indeed, should he even welcome it as the clearest sign yet that his efforts to change the Conservative Party are for real? After all, change that doesn't upset some people isn't change at all.

The benefit of the doubt—for now

It is disturbing that so many Tory activists appear to sympathise with UKIP's lounge-bar xenophobia and authoritarianism. But according to the party's MPs, most of them are still willing to give Mr Cameron the benefit of the doubt for as long as his tactics are succeeding and he looks like a winner. As one frontbencher put it this week: “If you spell it out to them, they can see that banging on about Europe and immigration would mess up the delicately constructed Cameron offer. They find it a bit unpalatable and he's not their kind of Tory, but they also know he's the only guy who can deliver the election.”

Nor need Mr Cameron worry too much about the blackmail of former donors. He is appealing to a wealthy new generation of younger and more liberal individuals who like him and approve of his direction. More than 200 have become members of the Leader's Club, which, for a minimum annual donation of £50,000, promises a couple of dinners a year with Mr Cameron.

But such calculations are beside the point. UKIP can make trouble for Mr Cameron—potentially quite a lot of it. To bend even slightly in its direction, however, would guarantee not only defeat, but ridicule. Mr Cameron is quite keen to avoid both.

See Bagehot's diary online this week at www.economist.com/daily/diary

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Global terrorism

On the march, not on the run

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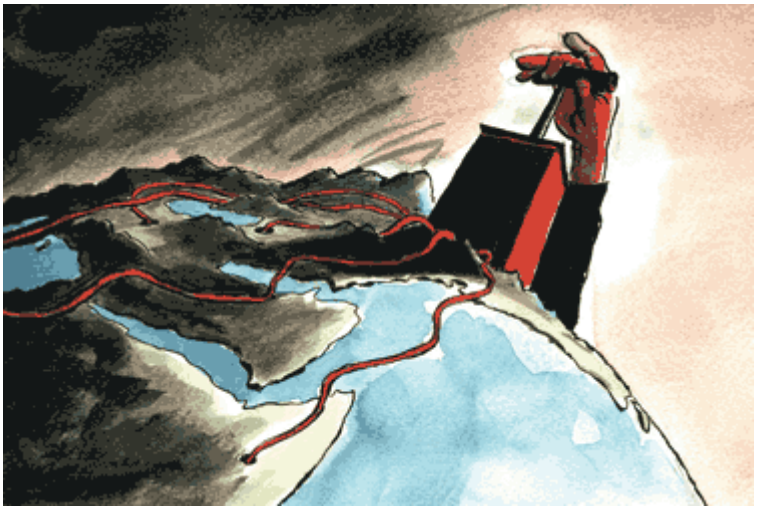
Claudio Munoz



Intelligence agencies see worrying signs of al-Qaeda's revival

Get article background

AS THEY watch Iraq spiralling into civil war and Taliban attacks in Afghanistan increasing, Western leaders have until recently consoled themselves with one thought: at least the campaign against al-Qaeda has gone quite well. “Absolutely, we're winning. Al-Qaeda is on the run,” said President George Bush in October.

The Taliban regime in Afghanistan gave al-Qaeda sanctuary. After the West toppled the regime in 2001, and arrested or killed many of al-Qaeda's leaders, officials believed it was largely broken up. Osama bin Laden and Ayman al-Zawahiri, his deputy, sent video and audio messages from their hiding places, but did not appear to control operations, which were “franchised” to local groups. In Europe, the jihadist cause was taken up by home-grown extremists. But their outrages, such as the London bombings on July 7th 2005, could not match al-Qaeda's spectaculars.

Such was the received wisdom. But in his annual threat assessment on January 11th, John Negroponte, America's outgoing intelligence chief, changed his tone. Al-Qaeda's core leadership was “resilient”. Its hiding places in Pakistan were “secure” and it was “cultivating stronger operational connections and relationships” with affiliated groups across the Middle East, north Africa and Europe.

That sombre view matches the alarm of British intelligence chiefs in recent months. In November, Dame Eliza Manningham-Buller, the head of the security agency, MI5, said her overstretched spooks were contending with some 200 terrorist networks involving about 1,600 suspects, and investigating up to 30 high-priority plots. Home-grown radicals were “foot-soldiers” trained and guided by al-Qaeda on an “extensive and growing scale”.

A series of investigations and court cases in Britain has cast light on the enduring role of al-Qaeda in attacks on the West, especially from Pakistan. In November Dhiren Barot, a Hindu convert to Islam, received a 40-year prison sentence after pleading guilty to planning several possible attacks. Arrested in 2004 soon after the capture in Pakistan of Muhammad Naeem Noor Khan, a senior al-Qaeda figure, Mr Barot had planned to use a radioactive “dirty bomb” and blow up limousines filled with gas cylinders in London, plus attacks in America against the IMF, World Bank and the New York Stock Exchange.

Intelligence agencies at first thought that the July 7th bombings had been home-grown. But investigators later found that the bombers' leader, Mohammed Siddique Khan, had travelled to Pakistan beforehand. In London this week, a court heard of a similar link in a second (failed) plot to bomb London's transport system two weeks later. The bombers' alleged leader, Ethiopian-born Muktar Ibrahim, had gone to Pakistan several months before the attacks and is said to have attended a training camp in Sudan.

This was not a “copycat” attack, but long planned, prosecutors said. It failed because, apparently, the bombers botched the kitchen-stove preparation of the ingredients, chiefly chapati flour, nail-varnish remover and hydrogen peroxide.

If this sounds too amateurish for al-Qaeda, then last August's alleged plot, for which a trial is pending, to blow up ten airliners flying from London to America by using liquid explosives, had all the hallmarks of an al-Qaeda spectacular. Investigators say that it, too, involves close links to extremists in Pakistan. In Canada, a group of Muslim citizens said to have planned to attack Parliament and behead the prime minister are also awaiting trial.

Western security officials say the revitalisation of al-Qaeda is partly due to the fact that “the pressure is off” in North Waziristan, a Pakistani tribal region where the army agreed a ceasefire with militants last September. Afghan and NATO commanders complain that the truce has also provided cross-border safe havens for the Taliban (see article). Mr Negroponte called Pakistan an important ally, but also “a major source of Islamic extremism”.

The same Western officials also worry about what they call “blowback” from Iraq: instead of sucking in would-be suicide bombers on one-way tickets, it could pump out battle-hardened fighters to wage violent campaigns elsewhere in the world. Mr Negroponte said an American pull-out would allow Iraq to replace Afghanistan as an al-Qaeda sanctuary.

In recent weeks al-Qaeda and its sympathisers have taken a beating in Somalia, where the American-backed Ethiopians have routed the local Islamists. But al-Qaeda may be growing stronger in north Africa. Last September's announcement of a merger of al-Qaeda and Algeria's Salafist Group for Call and Combat (better known by its French initials GSPC) may herald an attempt to open up a new front against Europe through its large population of Maghrebi immigrants. Mr al-Zawahiri predicted that “our [GSPC] brothers will be a thorn in the necks of the American and French crusaders and their allies.”

The GSPC has dwindled to a few hundred fighters. But alleged members have been arrested across Europe. Last month it claimed responsibility for a bomb that killed the driver of a bus carrying workers for an affiliate of Halliburton, an American energy-services giant. Such attacks have been rare of late. So are shoot-outs in normally placid Tunisia. Yet at least 14 people were killed in two recent attacks. The gunmen were said to have entered the country from Algeria. “Al-Qaeda is not on the run,” says Bruce Hoffman of Georgetown University. “It is on the march.”

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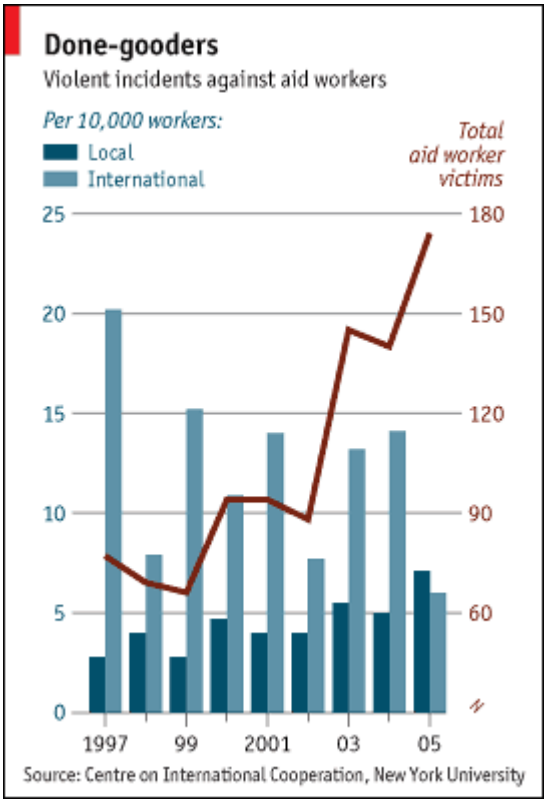
Aid workers

Doing evil to do-gooders

Jan 18th 2007
From The Economist print edition

Are locally hired aid workers really facing greater risks?



AS A display of contempt towards the sanctity of humanitarian assistance, a massacre, blamed on Sri Lankan soldiers, of 17 locally hired aid workers last summer takes some beating. Mostly shot at close range, they were discovered face-down inside their compound, still wearing the *Action contre la Faim* T-shirts that signalled their neutrality.

Such outrages are becoming more common. A dozen United Nations agencies this week jointly complained about attacks on aid workers in Darfur: in the past six months 30 compounds have been attacked and 12 staff killed, more than in the last two years combined. In December alone 29 vehicles were hi-jacked. According to a new report by the Centre on International Cooperation, a think-tank at New York University, locally hired staff, who make up around four-fifths of aid agency employees, are at particular risk. Increased precautions for expatriate workers are “cascading vulnerability” onto locals, it argues. The expats, expensive and potentially litigious if things go wrong, have better kit and training, but when things get ugly they often withdraw, leaving untrained locals to dodge the bullets. Aid groups, it says, have failed to consider the ethics of this.

That makes do-gooders queasy, not least because an image of pampered foreigners subcontracting violent death to hapless locals won't help fundraising. But the real reason for the rising toll could be the boom in aid: the number of employees rose by 77% from 1997 to 2005; the aid agencies' budgets have more than doubled in real terms. Michael O'Neill, director of security for Save the Children, terms the higher death toll “a product of growth”. The UN refugee agency argues in its latest report that the risk to individual aid workers has probably decreased in recent years.

It may even be foreign aid workers, not locals, who are at the greatest risk overall. Whereas violent incidents averaged 4.4 per 10,000 local staff in 1997-2005, the figure for international staff was almost three times greater.

But pressures to go to the worst places are growing. Peter Kessler of the UN refugee agency says aid workers now routinely enter areas they would once have avoided: “Journalists start showing up—often for half a day—and asking, ‘Why if I can get here can't the aid agencies get here?’”

Not that journalists are immune from criticism. Media organisations notoriously value staff correspondents' lives over those of freelances, let alone local interpreters, drivers and the like.

Aid workers might benefit from something similar to the Rory Peck Trust, named after a renowned cameraman killed during fighting in Moscow in 1993. It has successfully bullied big television news organisations to offer better training and insurance for freelances in hotspots.

But the real problem is the danger, not the bosses. Mr Kessler says: “All too often, aid workers are in the front lines, in places where most governments won't even send their own militaries.”

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About sponsorship

The politics of beauty

Fit to serve

Jan 18th 2007
From The Economist print edition

Looks can win votes—but being too pretty can lose them

NAMED last week as his party's candidate for the French presidential election, Nicolas Sarkozy faces an opponent, Ségolène Royal, who has the press drooling. “Dazzling” and “radiant”, she has been likened to a work of art (“Mona Lisa”) and a mythological figure (a “siren”).

Perhaps Mr Sarkozy should pay a visit to Chattanooga, Tennessee. The city's former mayor, Bob Corker, faced a similar problem in his Senate race last November. He prevailed against a congressman, Harold Ford junior, who was once counted among the 50 “most beautiful” people on Washington's Capitol Hill. In response, Mr Corker hurled one of the strangest insults in campaign history. He accused Mr Ford of being “an attractive young man”.

AP

Harold Ford's looks didn't help him

“This is not a beauty pageant,” Ms Royal's detractors are fond of saying. But what makes them so sure? The days are gone when a person would “vote for a pig if his party put one up,” as one British voter put it in the 1950s. Today, politicians must be well-groomed animals, selling their personalities not their parties. Looks can have an especially powerful influence on the minority of floating voters who determine election results, says Linda Bilmes, a professor of government at America's Harvard University.

In Ecuador, for example, Rafael Correa won the presidency last year with headline-friendly promises and camera-friendly looks. His “party” was an afterthought. In India, political parties often seem like shapeless nebulae illuminated by star candidates. The southern state of Tamil Nadu was the first to elect a film star as its chief minister. After his death in 1987, the position fell to two former actresses—his third wife and the inimitable Jayalalitha Jayaram, who rose to screen-stardom, according to one fans' website, “because of the frenzy for blond skin”.

It is tempting to try to prove that good looks win votes, and many academics have tried. The difficulty is that beauty is in the eye of the beholder, and you cannot behold a politician's face without a veil of extraneous prejudice getting in the way. Does George Bush possess a disarming grin, or a facetious smirk? It's hard to find anyone who can look at the president without assessing him politically as well as physically.

Such difficulties do not apply to Jyrki Kasvi. This fine-looking but little known fellow has represented the Uusimaa constituency in Finland's parliament since 2003. He was one of thousands of Finnish candidates whose looks were evaluated, on a scale of one to five, in one of the biggest-ever studies of beauty in politics, undertaken last year by three economists in Sweden and Finland*. The candidates' campaign photographs were rated by more than 2,000 non-Finns. Unclouded by politics (none of the candidates was recognised) the scorers showed a surprising amount of cross-cultural consensus—although the French were as usual notably harsh judges.

Did good looks really go together with electoral success? Incumbents could get by without them, the study found. But for newcomers, physical appeal might make all the difference: among the women, 65% of successful candidates were more beautiful than the average non-incumbent. For men, the share was 57%. A handsome man (ie, a perfect five) enjoys an edge over an ugly rival (ie, someone scoring only one) worth 6-8% of the vote. For the best-looking women, this edge is worth as much as ten percentage points.

AP

Not everyone looks good in the same way, of course. Senator Russ Feingold of Wisconsin triumphed in 2004 over an opponent ten years younger and better-looking. What let his opponent down, according to Leslie Zebrowitz, a psychologist at Brandeis University and Joann Montepare of Emerson College, was his “neotenous facial anatomy” or, to put it more simply, his “babyface”. Apparently, men blessed with round faces, big eyes, small noses and high foreheads are perceived as less competent, whatever their age.

All this looks bad for Britain's Conservatives and their neotenous leader, David

Cameron. But in Tennessee, Mr Corker's “attractive” rival was young, not baby-faced. So why did Mr Corker focus so hard on looks? “It was meant to demean,” says Tom Lee, who advised Mr Ford's campaign. He likens it to calling a sportsman an “athlete”, implying that unlike his rivals, he does not need to work very hard for success.

Mr Lee doubts this tactic affected the outcome. What voters want in their politicians, he says, is “authenticity”; to know that “you are who you appear to be”. Mr Ford, he says, could look equally authentic orating in a pricey suit or vote-hunting in a camouflaged baseball cap.

Of course, this advice is easier to swallow if you are authentically beautiful. Everyone else must think carefully about how real to be. Al Gore did not try hard enough: he wore too much make-up in his first presidential debate. Richard Nixon was too authentic by half: he lost his 1960 face-off with John Kennedy for want of a bit of powder which could have concealed his stubbly chin.

Perhaps the last, best example of the authentically slovenly politician is sitting in a prison cell in Rochester, New York. James Traficant, a defiantly unkempt congressman elected nine times by Ohio's 17th district, was expelled from the House in 2002 after being convicted of bribery, racketeering and tax evasion. His parting confession? “Do I do my hair with a weed whacker? I admit [it].”

Bob Corker's didn't hurt

*“The Looks of a Winner” by Niclas Berggren, Henrik Jordahl and Panu Poutvaara. IZA Discussion Paper 2311.

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In the money

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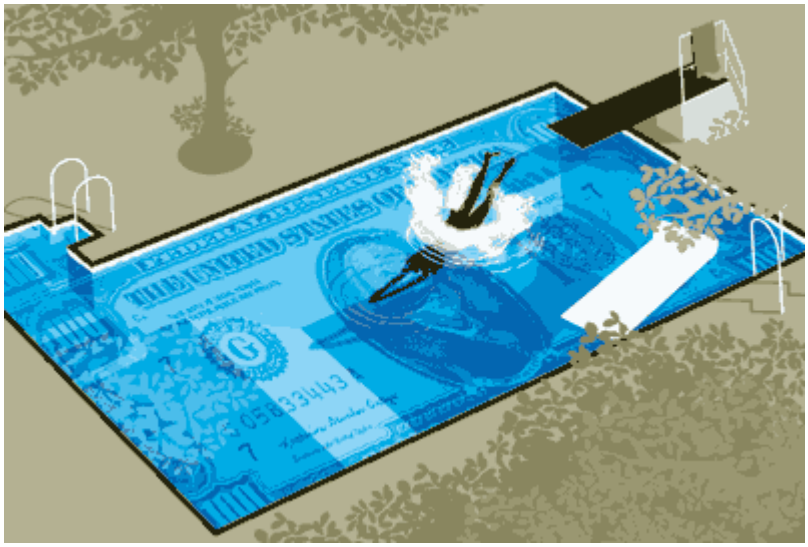
Jonas Bergstrand

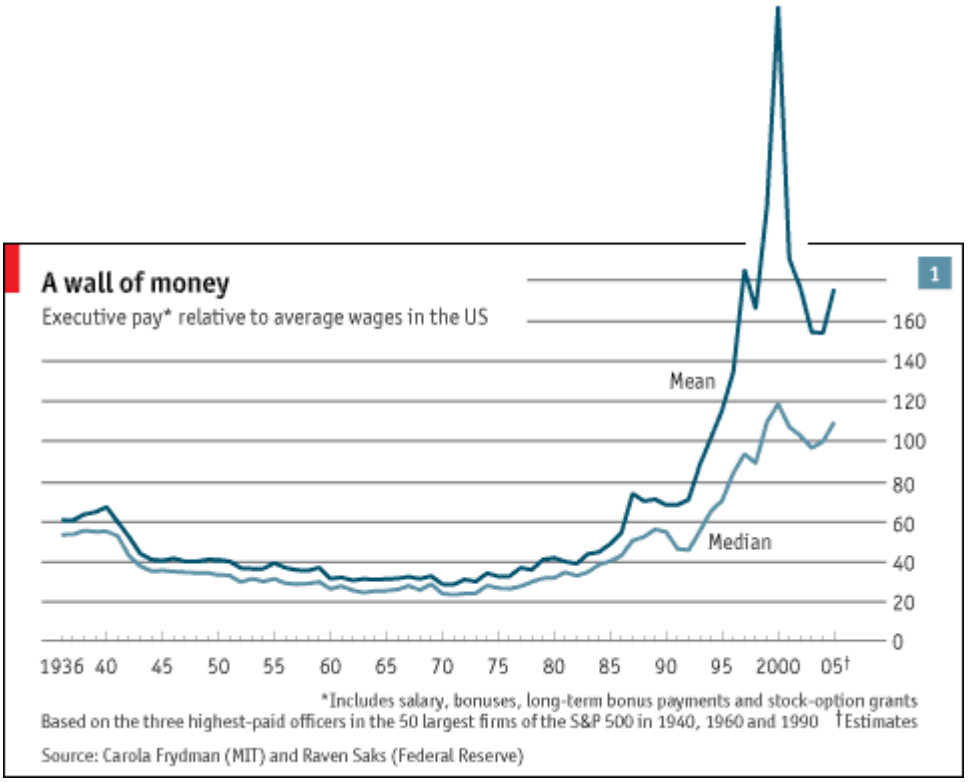


Executives have enjoyed an astonishing pay bonanza. Edward Carr explains why most of them deserved it

Get article background

RIGHT and left, Americans and Europeans, stockmarket investors and anti-globalisation campaigners all share one belief: top managers pay themselves too much. The evidence seems to bear them out. For almost half a century the ratio of top executives' pay to median earnings was as smooth as a boardroom table. Then, starting in America in the 1980s and a few years later elsewhere, this ratio began to increase before taking off exponentially and peaking around the turn of the millennium (see chart 1). At that point the worker on an American shop floor was earning in a year roughly what his boss on the top floor took home each evening.

Most people think they know what lay behind this. Greedy chief executives, abetted by weak, sycophantic boards, gorged themselves at the expense of savers—more often than not the very pension and mutual-fund investors who, as workers, had seen their salaries and benefit packages fail to grow.



To add to the grievance, many executives did not seem to deserve such rewards. Extraordinary pay for great performance is fine, it is routinely said. But many executives have been paid a fortune for presiding over mediocrity. The Corporate Library, an American corporate-governance consultancy, last year identified 11 large and well known but poorly governed companies, including AT&T, Merck and Time Warner, where the chief executive had been paid at least $15m a year for two successive years even as the company's shares had underperformed. Robert Nardelli received a $210m pay-off when he lost his job earlier this month even though the shares of his company, Home Depot, fell slightly during his six years in charge. Carly Fiorina, ejected from Hewlett-Packard almost $180m better off—including a severance payment of $21.6m—after a lacklustre tenure as chief executive, let it be known in her autobiography that money was not important to her. Not everyone believed her.

Unappreciated

No wonder the standing of executives has fallen so low. A poll for Bloomberg and the *Los Angeles Times* last year found that 80% of Americans thought executives were overpaid. Even those sympathetic to business are unsympathetic to its leaders. In a second-year class at Harvard Business School quizzed by Ira Kay, head of the compensation practice at Watson Wyatt, a consultancy, two-thirds of the students were critical of bosses' pay. In a survey, Mr Kay discovered that fully 90% of institutional investors—ie, companies' owners—thought executives were “dramatically overpaid”. So did 60% of their directors. That is quite a confession, given that directors are the very people who decide how much managers should earn.

But the diatribe against executives is mistaken. Poor governance alone cannot readily explain some of the most striking features of pay over the past few years. To dwell on the undoubted failures of governance is to gloss over the economic and corporate shifts that have been the main causes of the extraordinary rise in top managers' earning power.

National pay schemes vary greatly, and America remains ahead of, and more extreme than, other countries. (That, together with the superior quality of American data and the research they support, is why much of the material in this report is drawn from the United States.) But over the past decade all markets have displayed the same pattern: widening gaps between managers and workers and greater emphasis on long-term incentives. It is hard to see how this could have been caused by universally poor governance across so many different systems.

The chief mistake of the past 15 years was the granting of too many share options to too many people on terms that were too generous. That was costly and unwarranted, but it stemmed more from foolish accounting and tax policies supercharged by bull-market mania than from a sinister plot hatched in the executive suite.

This is not to deny the abuses and downright crookery that have marred executive pay. Even now, dozens of senior managers are under investigation for “backdating” their share options—illegally manipulating the timing of grants to increase the likelihood of a payment. Nor is it to assert that all is right in the boardroom. Indeed, the case for reform is strong.

It is, however, to argue that popular opinion is wrong. The lion's share of the executives' bonanza was deserved—in

the sense that shareholders got value for the money they handed over. Those sums on the whole bought and motivated the talent that managed businesses during the recent golden age of productivity growth and profits. Many managers have done extremely well over the past few years; but so, too, have most shareholders.

Between 1993 and 2003 the total pay of the top five executives in the Standard & Poor's 1,500, which accounts for roughly 80% of listed American companies by value, amounted to some $350 billion, according to Lucian Bebchuk and Yaniv Grinstein, of Harvard and Cornell Universities. The share of earnings consumed by those people's pay rose from 5.2% in the first five years of that period to 8.1% in the second five. And this is without counting the value of pensions, which can boost the total by as much as a third.

That is a lot of money, to be sure—though not quite as much as it sometimes seems. The “average” pay that is often quoted, and which is used as the basis for comparison with the “average worker”, is the arithmetic mean. Chart 1 above, from a different study, shows the average earnings of the top three executives all the way back to the 1930s. Whereas mean pay at the peak was 320 times average earnings, the median pay was “only” 120 times. In 2000-03 their mean annual pay was $8.5m and the median $4.1m. The median is a better measure than the mean because the mean for those top three is skewed by a few huge payments, often to company founders or family managers who are not standard executives.

Although overpaying a chief executive on its own is unlikely to bankrupt a company, there are other reasons to care about top pay. One is incentives. The role of pay is not to get executives to work harder (most are workaholics already, toiling towards an appointment with the heart surgeon), but to recruit good managers and get them to take difficult decisions. Shutting a subsidiary, sacrificing a pet project or forgoing a tempting acquisition is not much fun. Without the spur of high pay, managers tend to avoid such things.

Pay is also outsiders' most visible test of a board's capacity to monitor a company's executives. Mr Bebchuk, a fierce critic of the developments of the past few years, declares that “pay is not isolated: it is a classic board function important beyond just dollars.” If he is right that boards are unable to control pay, then poor governance is leaving managers free to use the company's assets for their own benefit. Excessive pay “undermines the notion that we can trust investment to managers and directors”, says Nell Minow, head of the Corporate Library. It becomes the justification for wide-ranging governance reform.

Lastly, executive pay is the most controversial aspect of the increasing inequality that has appeared over the past couple of decades. As the topmost echelon appears to be capturing a huge share of new wealth, everyone else's wages have barely shifted. This would be disruptive even if managers were felt to deserve what they are paid. It would be explosive if high pay continued to be seen as a swindle. Ultimately, businesses function with the blessing of workers, shareholders, customers and voters. If business leaders are universally seen as immoral and grasping, cynicism and mistrust will flourish and choke enterprise. Jeb Bush, a Republican former governor of Florida and no enemy of business, gave warning last year that “if the rewards for CEOs and their teams become extraordinarily high with no link to performance, then it undermines people's confidence in capitalism.”

Across the rich economies, governments have begun to demand disclosure of pay and new corporate-governance codes. In America's Congress Charles Grassley, a Republican and former head of the Senate committee on finance, is calling for boards to “do their job” instead of being “in hock” to managers. Barney Frank, the new Democratic head of the House financial-services committee, is likely to introduce a bill on pay.

All this makes business people extremely nervous. The difficulty is that they find it hard to discuss pay. (Imagine the talking point: “I am worth $100m because...”) Their case is seldom heard or examined. But “it is a societal problem,” says Jay Lorsch, of Harvard Business School. “If the business community doesn't do something, we are going to get more pressure from the federal government—and we don't want that.”

The arguments about pay are subtle and complex. They start with that moment in the 1980s when the long-established relationship between workers' and managers' pay began to break down. What could explain such a turning point?

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Grasso's big board

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How to make money on the stock exchange

Jonas Bergstrand

Get article background

THE clanging of the opening bell at the New York Stock Exchange came to stand for an unabashed bull-market period in financial history; the pay of Richard Grasso, head of the NYSE, has come to stand for some of the bull market's worst excesses. The diminutive, pugnacious Mr Grasso was the impresario of exuberance and paid himself as such.

At the time the NYSE was a not-for-profit organisation, though its members were among the planet's most enthusiastic profit-maximisers. As with all the best charities, Mr Grasso's board was crammed with august figures from Wall Street and corporate America.

Mr Grasso had joined the exchange back in the 1960s and worked his way up to the top job in 1995. In 2003 he was offered a new contract extending his time as chief executive and chairman of the exchange. To general amazement, this new contract provided for a lump sum of $139.5m. In a remarkably clumsy piece of “self-sacrifice”, Mr Grasso agreed to forgo a further $48m owed to him. Mr Grasso explained that the board had “blessed” him by paying him so well.

A report commissioned by the NYSE in late 2003 found a number of reasons for his “grossly excessive” pay:

• Mr Grasso had a strong influence over what he was paid. He helped to select the board and the compensation committee. He also had a hand in setting staff bonuses that would influence his own pay.

• He was friends with people on the compensation committee. The board was packed with prominent executives who were themselves very well paid.

• Mr Grasso's pension became, in effect, a concealed source of pay because he was able to convert it into cash while still working at the exchange. The report judged that this was against the rules of the pension scheme, although Mr Grasso disputes this.

• A recent court ruling, appealed against by Mr Grasso, found that he should have disclosed details of his pension to the compensation committee. “Year after year,” writes Judge Charles Ramos, of the New York Supreme Court, the committee “made decisions to pay him without knowing his true compensation”.

• The board included such luminaries as Kenneth Langone, one of the founders of Home Depot, and Dick Fuld, chief executive of Lehman Brothers. Judge Ramos condemned the board's lack of awareness of the sums going to Mr Grasso as “shocking”.

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The stockpot

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The story of pay is largely the story of share options

Jonas Bergstrand

Get article background

AS HEAD of RJR Nabisco in the 1980s, Ross Johnson used the corporate jet for his pet dog, listed as “G. Shepherd” on the passenger list. He employed maids on the company account and put sports stars on the payroll. Such were the trappings of power for the imperial chief executive before raiders stormed the citadel.

Private-equity outfits such as Kohlberg Kravis Roberts (KKR) changed all that. By rising up against inefficiency and waste in the corporations of the 1980s, they started the ideas that led to today's pattern of pay.

At the time the raiders were condemned for their greed. Looking back, however, what stands out is their largesse. They paid huge premiums on listed-company valuations. KKR, for instance, offered RJR's shareholders $12 billion more than their company's stockmarket value of $13 billion. Shortly before the KKR bid Mr Johnson was featured in *Fortune* magazine as a paragon of corporate leadership. The bid was a brutal demonstration of how the supposedly best had fallen short.

Buy-outs were a solution to a failing that has plagued the public limited company. One way to think of managers is as “agents” paid by the shareholders, who own the company, to act as stewards on their behalf. Agents do not share the same interests as the principals who employ them. They may, for instance, seek to use the company's assets for their own private benefit and shirk unpleasant decisions. So the corporation has devised mechanisms to mitigate these “agency costs”. Managers agree with owners to submit themselves to auditors, to answer to boards and to take part of their pay in the form of bonuses. All these things help to ensure that they act more in owners' interests.

But the system had its flaws. By the 1970s boards had become the creatures of management. There was minimal disclosure. Shareholders found it expensive to enforce their wishes. Rather than spending money to control wayward executives, they sold the shares and moved on, leaving managers almost unmonitored.

Free to spend other people's money, managers and directors squandered it. Instead of returning cash to shareholders, they kept it in the company. Businesses such as RJR typically spent too much money on pet projects, ill-advised diversification, obsolete operations, extravagant indulgences and pointless research.

The raiders' antidote was ingenious. By loading up the company with debt that needed servicing, the buy-out firms in effect took the decision about what to do with free cashflow away from managers and restored it to the capital markets. By taking the company private, they returned control of the board to the owners. And—what matters here—by motivating and monitoring managers, they got them to take tough, commercially astute decisions.

This analysis was articulated by, among others, Michael Jensen, an American academic, in a series of brilliant articles later gathered into a couple of books. The lessons were eagerly embraced by listed-company investors looking to emulate the raiders' results. Executives had been paid like bureaucrats, not just in that they were more or less given a job for life, but also because they were rewarded mostly for making their companies bigger rather than more profitable. Whereas executives in public companies earned about $3 for each extra $1,000 of profits, managers in the buy-out firms earned $64, according to Steven Kaplan, now of the University of Chicago.

In a world transformed by Ronald Reagan and Margaret Thatcher, it was time to pay managers more like entrepreneurs. The share option, until then chiefly a way of avoiding tax, began to be used as a device to make managers think like owners. Because an option confers the right to buy a share at a set price, it should motivate the manager to push the share price as far above that threshold as possible. A share, in theory, is the present value of all of a company's future dividends, so the long-term value of the company will go up. As it turned out—and as this report will explain later—this elegant solution to short-termism created its own set of problems. But it certainly motivated managers to try to maximise profits.

Options were handed out in astonishing quantities. Indeed, the story behind the growth of pay in the 1990s is really the story of the option. In 1992 S&P 500 companies issued options worth $11 billion. At its peak in 2000 the number reached $119 billion, though by 2002 it had fallen back to $71 billion (all in 2002 dollars).

Survival of the fittest

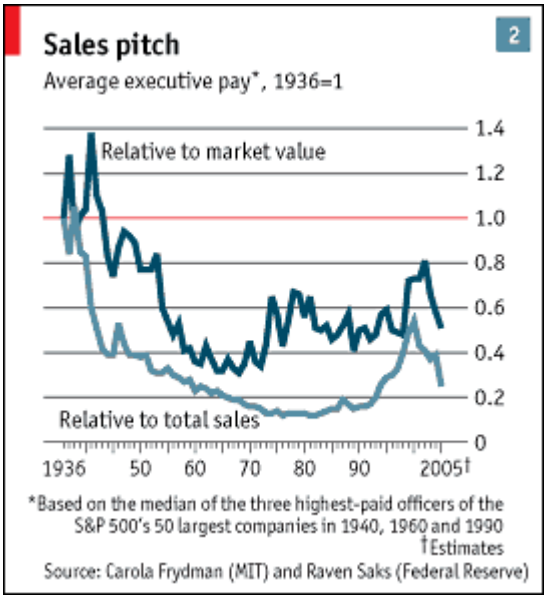
The new spirit of "shareholder value", as it became known, has brought about a change in the job of chief executive. For a start it has steadily become more precarious. Between 1992 and 1997, according to Mr Kaplan and Bernadette Minton, of Ohio State University, chief executives could expect to last about eight years in the job. Between 1998 and 2005 that fell to six years, and executives from underperforming firms were more likely to have been booted out by boards. The National Association of Corporate Directors and Mercer Delta, a change consultancy, looked at the replacement of 163 chief executives between 2002 and the first half of 2005 and found that a quarter of them were "non-routine"—meaning that the chief executive had been forced out or poached.

The growing tendency to jettison the chief executive may be one reason why boards have increasingly been searching outside the company for a replacement. According to Kevin Murphy, of the University of Southern California, that now happens in about one-third of such searches, compared with only 10% in the 1970s.

In addition, businesses seem to be placing a higher value on general management skills and relatively less on managers' special knowledge of their own company. That is the conclusion of Carola Frydman, of the Sloan School of Management at the Massachusetts Institute of Technology, who with Raven Saks, of the Federal Reserve, did the research on which Chart 1 (see article) was based. Ms Frydman found that senior executives these days have worked in more firms, have a broader experience within each company and tend to have joined the firm they lead later in their careers. (Business-school professors are also quick to point out that ever more bosses have MBAs.)

All this amounts to a new deal between chief executives and their companies, says Alan Johnson, a pay consultant who specialises in financial services. The job has become "Darwinian", he says. Chief executives are under pressure. They know that if the board does not like them they are out. In turn, executives have become more selfish and less loyal to their companies.

That deal changes the nature of executive pay. Managers will need compensating for taking on the increased risk of losing their job and the shorter tenure that goes with it. The same applies to the risk of taking on options, which are less valuable than cash because they are illiquid and not certain to pay out. Pay will also tend to be inflated by the growth in an outside market for executive talent. When your present employer is the only company likely to offer you a top job, it has a big say in your remuneration. The more other companies are bidding for your talents, the more you can demand. Ask Alan Mulally, wooed away from Boeing last year by Ford, which was in need of a saviour and prepared to pay a saviour's wage.



These changes were magnified by the bull market and in turn probably helped to feed it. Talk about the "entrepreneurial executive" was nothing more than rhetoric, because managers did not actually put their own capital at risk. But it became seductive in those heady years when options-fuelled start-ups were changing the world and the old economy was desperate to prove that it, too, could "get it".

The bull market did more than just increase share values: it also created a source of new demand for executives. Diane Doubleday, a pay consultant at Mercer, recalls how companies in the 1990s struggled to hire talent and keep it. George Shaheen's decision to quit his job as head of Andersen Consulting and join Webvan seems almost quaint now, if only because the dotcom grocer has long since been consigned to the great shopping trolley in the sky. But at the time it sent a shiver through corporate America.

All the while another more general force was pushing up executive pay. As the average firm size increases, so each company must pay its top executives more. When managers control more assets, they can make more of a difference to absolute profits. Hence, in a competitive market full of bigger companies, boards will be prepared to spend more on talent. Using a schematic mathematical model, two American-based European economists, Xavier Gabaix and Augustin Landier, concluded that the sixfold increase in the size of American firms between 1980 and 2003 may account for much of the sixfold increase in managers' pay during that period. Tiny differences between the abilities of top managers could explain large differences in pay. Chart 2 (above), from another study, shows how in historical terms the level of pay is still relatively low in relation to the size of companies.

Had executives exploited lax governance to cash in, you would expect them to have done far better than high-flyers in other professions. Going by Social Security data, executives of non-financial companies

represented 20% of the 30,000 or so Americans with the biggest incomes in 1994. But in spite of the huge increase in their pay over the following ten years, executives made up only slightly more of that group in 2004, according to Mr Kaplan and Josh Rauh, also from the University of Chicago. The results from tax-return data indicated a larger increase in the number of executives among the very richest Americans. But even then, the authors conclude, the growing prosperity of the very rich cannot be explained by the growing prosperity of executives alone: other high-flying groups were rapidly getting richer, too. There are fewer rich lawyers than rich executives, but in the decade to 2004 the lawyers joined the richest group at a faster rate. So, too, with financiers, who are both more numerous than they were and more numerous than high-earning executives.

In fact, the typical chief executive of an S&P 500 company, who earned just under $7m in 2005, according to the Corporate Library, must think he is in the wrong job. According to Mr Johnson, the pay consultant, senior investment bankers stood to earn bonuses of $20m-25m in 2006 and top traders $40m-50m. To qualify for Institutional Investor's *Alpha* magazine rankings of the top 25 hedge-fund managers in 2005, you had to earn $130m.

Metering merit

Yet if the level of typical pay is within the bounds set by other professions, what about the pattern? After all, the main idea of the shareholder-value movement was that pay should depend on the company's financial performance.

For an answer, look at a second study by Messrs Kaplan and Rauh. They assembled several groups of companies with similar-sized assets (to allow for the fact that pay depends partly on a company's size) and, within each size-group, sorted the chief executives into ten pay classes. They then took all the executives from the top class in each group and compared their companies' share-price performance with that of their competitors; ditto for the second-to-top class, and so on. Chart 3, above, shows a clear relationship between pay and performance.

Given that managers receive such a large part of their pay in shares, perhaps that should come as no surprise. But it is often suggested that the value of executives' option packages bears no relation to their performance. One reason for this may be a confusion between a manager's target pay and what he actually ends up with. Remember that options have no fixed value: their worth depends on how the share price at the time of the sale compares with the strike price. So assessing the value of someone's options on the day they are granted involves guessing what the underlying shares will one day be sold for, and that number may be quite different from the price actually achieved several years later. If the company has prospered, the options could be worth more than expected; if it has struggled, they may have no value at all. Watson Wyatt found that successful and unsuccessful firms alike grant long-term incentives such as options. However, managers of the top companies ultimately earn three times as much as managers of the laggards.

To sum up the argument so far: executive pay reached an inflection point in the 1980s, when attacks from raiders prompted companies to use options to motivate the chief executive to make profits, punish failure with dismissal and value general management skills more highly. This corresponded with a period of outstanding prosperity in which both top executives and other high-flyers did extremely well. But that story is incomplete. And the more closely you look at what really goes on inside boardrooms, the more incomplete it seems.

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Kilts complex

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Expensive, but worth it

Jonas Bergstrand

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NOBODY minds high pay when it is deserved, you often hear; what is objectionable is high pay for failure. In reality, though, people like to criticise high pay whether it is deserved or not.

Take the career of James Kilts. As chief executive of Gillette, Mr Kilts sold the maker of batteries and shaving kit to Procter & Gamble for $57 billion at the start of 2005. The deal cost Boston, Gillette's home town, a corporate scalp and earned Mr Kilts opprobrium for the size of his bounty.

P&G paid a handsome price for a company that had been in a thorough mess when Mr Kilts took it over in 2001. At the time he was already a rich man, having made his fortune turning around Nabisco, which he had sold to Philip Morris. He seemed to be facing a huge challenge at Gillette. But under his leadership the company revived its flagging Duracell battery business and made a good fist of some big product launches in the shaving business. In the four years that Mr Kilts was in charge, Gillette's shares rose by 50%. Its sales in 2004 grew by 13% and net profits by 22%. Some other consumer products may have done even better, but that is not the issue.

Gillette had become an enticing prospect for P&G, which saw the company's brands as an ideal fit for its international network. But Mr Kilts got brickbats rather than bouquets, especially for his pay-off. According to a Harvard Business School case study of the acquisition, he had agreed to a salary and bonus of some $4.4m a year when he joined Gillette, relatively low by the standards of similar companies. However, he was given a large number of options, all of which vested on the sale to P&G. Upon selling Gillette, he also received shares from P&G to persuade him to stay with the new company for a year. The total value of all these shares amounted to some $150m, according to the *Wall Street Journal*.

In spite of the grumbles, some investors were happy. Warren Buffett, a critic of excessive executive pay and boss of Berkshire Hathaway, which owned 9.7% of Gillette, wrote: “Jim quickly instilled fiscal discipline, tightened operations and energised marketing...Jim was paid very well—but he earned every penny.”

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Power pay

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When the game is rigged in favour of the boss

Jonas Bergstrand

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WARREN BUFFETT has repeatedly used his “letter” to Berkshire Hathaway's shareholders to complain about pay. The “boardroom atmosphere almost invariably sedates [directors'] fiduciary genes,” he observed on one occasion. “Collegiality trumps independence.” In 2003, with the scandals of WorldCom and Enron still smouldering, the great investor issued a challenge to directors across the country. “In judging whether corporate America is serious about reforming itself, CEO pay remains the acid test,” he wrote. “To date, the results aren't encouraging.”

One sign that something is amiss comes from studies that seem to point to a failure of governance. Take research by Marianne Bertrand of the University of Chicago and Sendhil Mullainathan, a Harvard economist. Reasoning that executives should be paid for their own accomplishments but not for sheer good fortune, they investigated whether chief executives were in fact paid for luck.

In the oil industry they found that chief executives' pay always benefits when the oil price is high, but does not necessarily suffer correspondingly when the price is low. Across a large collection of companies, they looked at the effect of changes over which managers have no control, such as shifts in exchange rates. They found that the typical firm rewards its chief executive as much for luck as it does for good performance. The effect cannot be explained simply by the increase in the value of managers' share options: it also shows up in their base salaries and bonuses, which are directly controlled by boards. Revealingly, the rewards for luck were smaller in companies that were judged to be well governed.

The most compelling evidence that governance matters comes from putting aside the abstractions of economists and examining what really happens inside companies. The way that new chief executives are hired, studied in forensic detail by Rakesh Khurana, a professor at Harvard Business School, is especially flawed.

Can you keep a secret?

For a start, information flows poorly, because both buyer and seller are at high risk from leaks. The executive does not want to let his employer know that he has been talking to another company—probably a competitor—until the deal is done. The hiring company is scarcely less comfortable. It does not want the identities of its favoured candidates to be known because it might end up hiring someone who is obviously the second or third choice.

That is what happened to John Walter as head of AT&T in the 1990s. The unfortunate Mr Walter was clearly the runner-up to Michael Armstrong, who had turned the job down. On news of the appointment, analysts spoke of “a mistake”. CNN, Mr Khurana recounts, called Mr Walter “a puzzling choice”. AT&T's stockmarket value fell by $4 billion. Mr Walter lasted less than nine months, and when Mr Armstrong did eventually take over there was general euphoria—until he proved no more able to restore the company's fortunes than Mr Walter.

As that cautionary tale shows, the choice must satisfy not only the board itself but also stockmarket analysts and the financial media. The need for external approval is all the greater if the company is in the throes of some crisis, as it so often is when the board feels compelled to go outside for a new chief. Imagine the circumstances: the previous boss has left in disgrace, the share price is falling, commentators are dragging the company through the mud, the employees are anxious and disillusioned. The board feels compelled to act swiftly.

Hence the list of potential candidates is a short one. Some three-quarters of chief executives appointed from outside between 1985 and 2000 were already chief executives or presidents elsewhere. That sort of background helps to establish their credentials, but the companies they come from also have to be seen by analysts and by the press as successful (even though nobody knows precisely what part the bosses played in that success).

The whole process is carefully choreographed by the headhunters, who act as matchmakers between the two sides. By the time the board and the candidate meet—and they may meet only once—the union is all but decided. With billions of dollars of market value at stake, the board may be inclined to overlook a few million dollars of pay. “The nightmare scenario for the board at this point is having to restart the process,” one candidate told Mr Khurana. “So you ask. And you get.”

Which is why outside candidates are offered the sun and the moon—and why they demand that the stars be thrown in as well. They are probably leaving behind a valuable options package that will have to be “made whole”. The chances are that they have swapped a secure future for a risky (but potentially very remunerative) roll of the dice at the new company.

Jonas Bergstrand

Understandably, before they sign the contract, new executives bargain to make their bonuses and options more secure. This is the moment when the board caves in and offers the most offensive ingredients of executive pay. The oxymoron of the “entrepreneurial manager” is shown up by safety devices such as guaranteed bonuses, severance pay, hugely generous provisions if the company changes hands, perks, accelerated vesting of options and massive pensions contributions. But boards may think that is the price of getting their man or woman.

“Once they have employed the guy, they want to police the CEO,” says Jay Lorsch of Harvard Business School. “But they have given away the store. It is worked out at the beginning. Having made the deal, how do you contain this thing?”

The board's inability to stand up to the incoming chief executive is an example of a more general spinelessness documented by Lucian Bebchuk and Jesse Fried, of Harvard Law School and the University of California at Berkeley. Boards are agents, too, and Messrs Bebchuk and Fried believe that their interests are more closely aligned with those of powerful executives than with those of the owners they are supposed to represent. As a result, the bargaining over pay is not at arm's length and boards conspire with executives by providing all sorts of “stealth pay” that disguises the true extent of their rewards.

The director's role is ambiguous, because he is charged with counselling the chief executive as well as monitoring management's performance. The duty to offer friendly advice inevitably interferes with the duty to admonish and if necessary to sack. The conflict has intensified as boards have been loaded up with responsibilities. As Richard Schmalensee, dean of the MIT's Sloan School, puts it: “You ask hard questions to prevent dumb decisions. If you pretend to be an auditor without the time to be one, who is going to listen to your advice?”

Messrs Bebchuk and Fried argue that the chief executive can co-opt the directors in all sorts of ways. Although executives no longer decide who is nominated to become, or remain, a director, they still have a large influence over the pay and composition of the board. Business dealings between executives and directors should be declared and must not be large, but executives can determine whether the company gives money to a director's favoured charity, and they control special payments. In addition, many directors were once chief executives themselves and are likely to think that others in that job deserve to be well paid. Boards face some constraints from investors and predators, but as long as they do not attract notoriety they have plenty of leeway.

To support their arguments, the two academics looked for evidence that weak boards pay powerful chief executives more. They found, for instance, that high pay is associated with large boards (which are easier for the chief executive to dominate), companies that have no outside shareholder to monitor them, and companies protected by anti-takeover provisions. The researchers highlight some cases in which the board's behaviour seems to have run counter to shareholders' interests. When Jill Barad left Mattel's top job because the toymaker was performing poorly, she was forgiven a $4.2m loan, handed $3.3m to pay the tax on the forgiveness of another loan and had her options vested. None of that was in her contract, which did, however, provide for a payment of $26.4m, which was duly made. Perhaps Ms Barad's allies on the board were willing to see her go only if she was showered with money. But would the directors have been so generous if they had been paying it out of their own pockets?

The great irony is that the most imaginative scheme to mitigate the agency costs of the public company ended up creating agency costs of its own. Options were supposed to make managers think like owners. But as Michael Jensen and Kevin Murphy explain, in an overvalued stockmarket options can make managers more short-termist than ever. Bob Monks, a veteran corporate-governance reformer, calls them the “enablers of excess”.

To see why, think of a manager who owns options in a company that is heavily overvalued. He knows that the company will not make enough money to justify its valuation. Yet many people's prosperity—including the manager's own—rests on the share price remaining comfortably above the options strike price. The temptation is for the manager to use his inside knowledge to buoy up the share price in the short run. He can make acquisitions, delay investments or manage earnings using questionable accounting in the hope that some unexpected good news will turn up or that he will win enough time to make money from his options. In one survey, well over half of the chief financial officers being questioned said that they would cut a value-creating investment rather than miss an earnings target set by the market. And sometimes managers will resort to earnings manipulation and fraud. Anyone who lost money in Enron knows how that can end.

Built-in asymmetry

To make matters worse, options were often granted on over-generous terms. Consider an example from a *Fortune* 500 company described by Messrs Jensen and Murphy. When the company's share price was $57, managers were granted options “at the money”, that is with a strike price also of $57. They told the board that they expected the share price to rise to $100 in five years. The company's cost of capital was agreed to be 15%, and a dividend of 2.5% of the share price was being paid. The shareholders would therefore need a share-price rise of at least 12.5% a year if they were to cover their cost of capital. On that arithmetic, the share would have to rise to $102.72 over five years. If the markets believed the managers, today's share price would be too high and investors would sell. Messrs Jensen and Murphy calculate that the share price would fall by about $1.50. On the other hand, if the managers achieved their modest $100-a-share target they would be $43 a share better off.

In the bull market boards tended to hand out set numbers of options each year, regardless of the share price. That seems odd, because if the firm had doubled in value in a year the options grant would automatically be worth twice as much. Executives were often able to sell shares as soon as the options had been exercised. That was good for the executives, who could diversify their investments. But it was bad for the companies, because the executives had less incentive to behave like shareholders.

At the peak of the bull market, the boards of some new-economy companies were giving away more than 7% of the equity a year, heavily diluting the original shareholdings. Most pay experts think that board directors mistakenly believed the options they were giving away were free, which is economic nonsense.

In sum, the market for chief executives is flawed and boards find it hard to stand up to executives. Options were handed out too easily and, in the internet bubble, encouraged short-term behaviour. There has been plenty of misgovernance.

Clearly all this had an effect on pay. The question is, how much?

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McGuire makes good

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From The Economist print edition

But how much is too much?

Jonas Bergstrand

Get article background

WHATEVER else you may accuse him of, William McGuire was no bureaucrat. Under his leadership over 15 years, UnitedHealth Group saw its sales grow from $600m to more than $70 billion. The health insurer's share price rose almost 85-fold, 30 times more than the S&P. That was enough to make Dr McGuire a fabulously—and deservedly—rich man. At their peak, his options were worth some $1.7 billion.

Dr McGuire had it good, but he wanted it better. Late last year he and his number two at the company agreed to pay back about $390m between them because the money was made from backdated options awards—that is, the timing of their options had been illegally manipulated to take advantage of a rise in the share price. It was one of many examples of a practice that spread surreptitiously across America, though it was curbed after Sarbanes-Oxley required an options grant to be registered within two days.

An outside report into the backdating commissioned by UnitedHealth found that on 16 dates between January 1994 and August 2002 options were granted to the executives and other employees at one of the lowest share prices of that quarter. That would be extremely unlikely to happen by chance. Altogether, the report concluded, almost 80% of the options granted during this time had been backdated.

Equally disturbing for shareholders was the directors' decision to grant fistfuls of new options in October 1999 as a replacement for “suspended” options that had gone “underwater” (in other words, where the strike price was above the company's share price). Inexplicably, the directors not only agreed to this new issue when the underwater options were in fact back in the money, but about a year later, in August 2000, they also “reactivated” the suspended options. Those decisions were worth many tens of millions of dollars to Dr McGuire. The compensation committee told the outside scrutineers that it had not realised Dr McGuire had stood to gain so much.

The report also noted that William Spears, the chairman of the compensation committee, had been a trustee for Dr McGuire's children and had managed some of his family's investments. In addition, Dr McGuire had backed Mr Spears's money-management firm. The two men insisted that the board knew of this potential conflict, but other directors seemed unaware of it.

At the end of last year Dr McGuire left the company he had done so much to turn into a success. He and UnitedHealth are still wrangling over how much of his pay he will keep.

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The market rate

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Executives' large pay packets cannot be blamed on poor governance

Get article background

THE *Wall Street Journal* was in no doubt. Under the headline “Option Opulence”, it reported how the “bull market is bringing huge ‘paper' profits to executives” of companies granting options. The *New York Times* was able to disclose that several inquiries were under way into the “untimely bounteousness” that had created a “new and resplendent class of workers whose emoluments exceeded those of most great owners”.

The quaint turn of phrase gives the game away. Those two articles, the first from 1955 and the second from 1933, show that public disquiet—outrage even—about bosses' earnings is as old as the executive dining room.

The most recent great paroxysm in America was in the early 1990s, at the time when Graef Crystal published his book “In Search of Excess”. It produced a law that tried to cap the chief executive's salary at $1m, using the tax system. The law caused some bloodletting, but proved a sensational failure: the $1m ceiling in effect became a floor as companies raised their managers' basic pay to the threshold. Christopher Cox, chairman of the Securities and Exchange Commission, last year told the Senate banking committee that the law “deserves pride of place in the museum of unintended consequences”.

Just as misgivings about pay seem to crop up in every generation, so they crop up in just about every economy, too. Even Norway, which has one of the world's most compressed pay scales, has introduced laws on disclosure and votes on remuneration (as indeed have most other European countries).

That people everywhere are perpetually irritated by the boss's pay is a good reason to hesitate before drawing conclusions from the latest fuss. It is hard to say, for instance, whether people last year were more annoyed by Lee Raymond, the long-serving head of Exxon Mobil, getting a parting pay packet of some $400m or by the rise in the petrol price to $3 a gallon.

The public debate on pay draws heavily on individual examples, some of which can be found in the short boxes spread throughout this report. Such anecdotes make an impression partly because they are so dramatic and partly because there is no way of offsetting them by examples of people who have been paid just the right amount.

What the anecdotes show is that chief executives sometimes abuse their position and that boards sometimes pay them too much. That may be wrong, but it is not surprising. After all, the shift from imperial chief executive to options-rich manager is founded on the idea that companies are run not by philosopher-kings pursuing the common good but by people made of flesh and blood and with a keen sense of self-interest. Similarly, pay packages are complex contracts that may be drawn up in one set of economic circumstances and enacted in another. Any market will produce examples of people who overpay at the peak of a boom, say, and live to regret it when the bubble has burst. The question is what all these particular stories reveal about governance in general, and about its part in explaining the rapid increase in executive pay.

Wrong time, wrong place

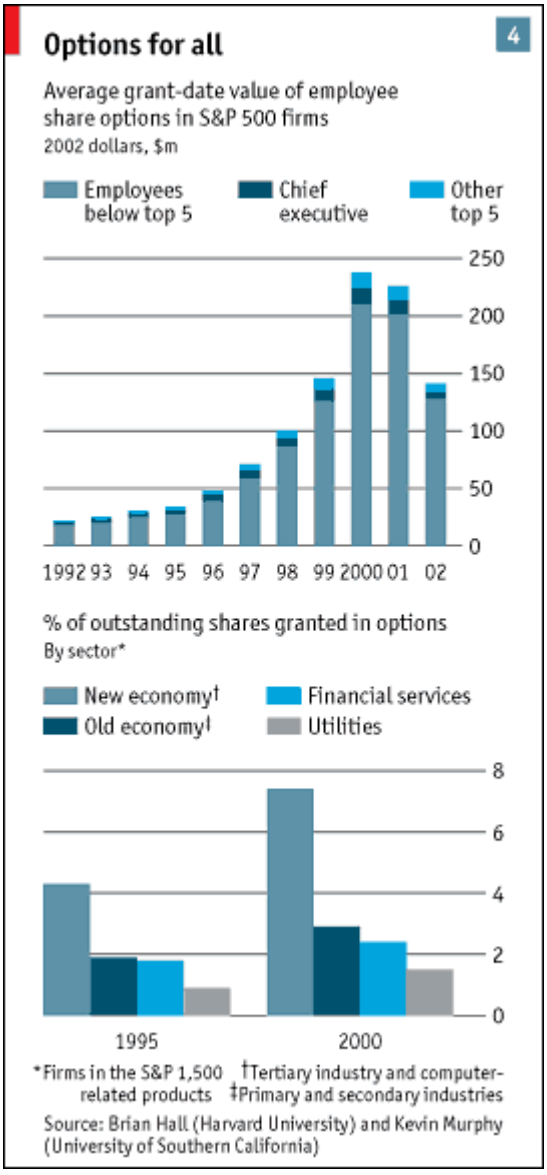
The main weakness of the governance explanation of excessive pay is that the conduct of boards and the market for chief executives have both been improving in recent years. Pay took off at a time when executives were under more scrutiny than in the 1950s and 1960s, a period of restraint in spite of a bull market for equities. It is hard to explain by weak governance why powerful executives back then should have passed up the chance for higher pay that their less powerful successors were later able to seize with both hands. Similarly, flaws in the system of hiring executives can explain rapidly increasing pay only if the market had failed sensationally in the 1980s and 1990s. Instead, the market for executives has grown steadily. Certainly it is imperfect, but it is less imperfect than it used to be.

The pattern of pay over the past few years is also hard to explain in terms of governance. Thanks to new listing rules adopted by the New York Stock Exchange in 2003, chief executives are no longer on the nomination committee for directors, they cannot receive loans from directors, directors are more independent, and pay consultants work

directly for the compensation committee rather than reporting to managers. Moreover, after the controversy over pay and the scandals following the collapse of the internet bubble, boards can be in no doubt that the chief executive's pay will now be subjected to minute scrutiny.

David Nadler of Mercer Delta, a change consultancy, describes all this as a fundamental change in the authority of the board. “For 20 years you didn't need to know about the board,” he says. In the bad old days board members used to fall asleep and drink too much. When people were unprepared for board meetings, everyone would laugh, “give 'em lunch and send 'em home.” These days boards are monitoring their own performance and seeking advice on how to cope with splits and conflict. Boards must routinely meet in “executive session”, that is, without the chief executive present. That encourages directors to talk frankly and raise questions without seeming to confront managers or undermine their authority. Executives “used to talk about ‘my board' in the imperial sense”, Mr Nadler says. “Now managers are employed by the board.”

If excessive pay were chiefly the result of poor governance, such improvements might have been expected to bring about a large and permanent downward adjustment in executives' remuneration. After the stockmarket bubble burst, median pay did indeed fall a little, and the arithmetic mean much more. Some, if not most, of the fall can be put down to the decline in the stockmarket. After all, executives are paid partly in shares, a currency that had just suffered a big devaluation. But the effect was relatively small and temporary. By 2004 pay in the largest companies was again growing much faster than average workers' wages. By 2005, according to Mercer, the total pay of the chief executives of 350 large companies had easily surpassed its level in 2002 (see chart 1 in the introduction to this report). Better governance may have lowered pay, but not by much.



In fact, the argument that powerful incumbent chief executives use their influence to wring extra money out of weak boards is hard to square with what has happened in the market for outside executives. In the 1990s, when incumbent executives were extracting more money than ever before from their particular firm, a record number of managers voluntarily gave up this advantage by leaving for new companies, where they would typically start off with less influence. Moreover, executives were able to keep their salary high when they changed firms. The fat pay packet which according to the theory depended on managers' power over their old board turned out to be transferable to other jobs where the managers had to negotiate with strangers on the new board. That looks like a market at work, not a rigged game.

The third main complaint about governance in the 1990s was that executives were granted too many options on easy terms. Yet, on closer inspection, this accusation also needs qualifying. It is clear that a sort of mania took hold in the 1990s and that boards were extravagant with options. This makes options a failure of governance, but not one that fits the common view that top managers were exploiting investors. Brian Hall of Harvard University and Kevin Murphy of the University of Southern California have established that top executives received under 10% of the options handed out at that time. The rest went to other employees—in some companies to all employees. Such generosity was not restricted to Silicon Valley. In 2000, for instance, “old-economy” companies gave employees below the top five an average of $2,559 each in options.

Dishing out options to the office cleaners makes no sense. Options are an expensive way to pay employees: they are worth less to workers than they cost the company to issue. This is because options cannot be freely traded, and workers may feel that if they already depend on their firm for their job, investing in the business as well means having too many eggs in one basket. For such people, cash is much more valuable. For companies, one reason for issuing them was to inspire loyalty and provide an incentive to stay on. But option grants outside management have fallen steeply since 2004 and will, consultants predict, eventually disappear altogether.

Governance critics also saw something sinister in the easy terms of options packages. In the 1990s these were almost always “plain vanilla”, granted at the current share price, with a vesting period of three years and without any performance hurdles. Executives got them just for turning up to work (“pay for pulse”) as they waited for the bull market to lift the share price.

That design was hardly demanding, but it was encouraged by America's accounting rules rather than by greedy executives. Contrary to both economic logic and the principles of accounting, options granted at or above the day's share price did not count as an expense in the accounts and eventually delivered a tax credit to the company. On the other hand, options “in the money”, ie, below that day's share price, or with performance hurdles attached, were

charged as a cost. Advocates of governance reform argued, reasonably enough, that “expensing” options should not affect a company's stockmarket value, as it would not affect its cashflow. The failure to attach hurdles to options was a failure of governance.

However, such advocates underestimated people's enslavement to accounting conventions. In the past two years there has been a flowering of long-term incentive plans of a different kind. According to Scott Olsen, a pay expert at PricewaterhouseCoopers, performance hurdles are now common. There are longer vesting periods and holding periods after the options have been exercised. Worried about dilution, investors have successfully pressed companies to issue “restricted” shares which their owners cannot sell freely. The shift from standard options was prompted by an accounting change that came into force in America in 2005, requiring options of all sorts to be expensed. The performance hurdles are mostly based on internal measurements, because market-based tests still receive less favourable accounting treatment.

Everybody's doing it

International pay patterns add to the evidence that American pay was determined chiefly by the market. National pay cultures vary, with long-term incentives playing a far more important part in America than anywhere else (see chart 5). Options for executives were first adopted in continental Europe about ten years ago and grew rapidly almost everywhere. According to Harm van Esch of Russell Reynolds, an executive-search firm, industries that are particularly exposed to international competition, such as the technology sector, have changed faster than more local ones such as construction.

Piia Pilv, of Mercer's pay consultancy, has noticed a similar pattern in eastern Europe and the Middle East. At first clients were interested only in getting hold of international pay data, but soon afterwards they started looking at the design of long-term incentive plans. Multinationals that are grappling with different pay schemes in different markets lead the way, along with industries that employ lots of foreign executives. In the Middle East, says Ms Pilv, private companies are rapidly raising pay towards international norms, but the state-owned sector is slower. Whereas Japan is a laggard, Chinese companies are embracing long-term equity incentives. Early government approval was given in 2006 and now some 100 firms, such as ZTE, a telecoms-equipment group, are planning to use long-term incentives to motivate managers.

Pay-consultancy services offered by firms such as Mercer, Frederic W. Cook, Watson Wyatt and PricewaterhouseCoopers have themselves proved controversial. Critics complain that the data they provide help to ratchet up pay because almost all companies seem to want to pay their executives at or above the average (a statistical impossibility), and that the consultants suffer from conflicts of interest. In the past they reported to the chief executive rather than to the board. That arrangement has been outlawed by the New York Stock Exchange, but sometimes the consultancies have other large contracts with the company which are in the gift of the very executive whose salary they are helping to set.

It is feeble of boards and managers to blame the consultants for everything. Directors were always free to decide whose advice to take and whose to ignore. And companies have good reason to follow the crowd in pay because good packages are difficult to design. Bengt Holmstrom, a professor at MIT, points out that some of the most astounding pay packets were offered by companies such as Apple and Oracle whose boards adopted unusual structures or turned their backs on comparative data.

Accusations of conflict have more substance. Quietly, a few consultants will admit that in the 1990s the standard of advice sometimes fell short—though of course only at other consultancies. But the consultants' job has changed since they stopped working for executives and took up with the board instead, and they themselves seem happier to work that way.

How to cut severance pay

Even the most controversial elements of pay may have a market logic. Krishna Palepu of Harvard Business School observes that companies preach the rhetoric of pay for performance but go on to guarantee the payout, using devices such as severance payments. Perhaps that is because a company cannot go on piling risk onto its executives. Imagine a board replacing an executive's standard options with a type that pays out only if the company's share price beats an index of its competitors. Such an option, recommended by some advocates of governance reform, has the advantage for the company of rewarding the executive for doing better than his peers but not for a piece of luck that affects everyone equally. But it is a riskier proposition for the executive. Messrs Hall and Murphy calculate that a standard option has a probability of 80% of paying out at the end of ten years, compared with less than 50% for an indexed option.

In Britain investors sought to tighten long-term incentives so that they paid out only for companies that had done better than average. One device was to award restricted shares based on share-price performance and dividends that outclass similar companies. According to PricewaterhouseCoopers, the trouble with such plans is that they do not pay out often enough. That is bad for the companies as well as for their executives, because a scheme that frequently fails to pay out soon loses its motivating power. Companies have responded by easing the rules for other incentive schemes, such as the annual bonus.

Boards could do away with severance payments and the like, but at the cost of making executives' jobs even riskier. That holds two worries for companies. First, a riskier job would attract a different kind of applicant, so companies might find it harder to lure an executive from a secure perch at a successful public company. Second, those applicants who were not put off by the extra risk might well expect extra compensation for it. So the reforms advocated by governance activists would sometimes result in even higher pay than they do now.

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Kleinfeld misses out

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Timing is all

Jonas Bergstrand

Get article background

NEWS in September last year that Siemens's top managers were to get a pay rise of 30% provoked immediate protests. The German electronics conglomerate is in the midst of painful restructuring as it seeks to cope with competition from lower-cost rivals abroad. Protest turned to fury a few days later when it emerged that BenQ, a Taiwanese telecoms group, had decided to close down the mobile-handset maker it had bought from Siemens only a year earlier. During its year as owner BenQ had lost around $1 billion.

Siemens's top managers had been granted the increase because their pay had remained flat for the past three years. But with BenQ's German workers likely to lose their jobs, German unions and politicians rounded on Siemens. Whereas in Britain or America Klaus Kleinfeld, Siemens's chief executive, and his colleagues might have been praised for disposing of a failing business and having at least won a reprieve for its staff, in Germany he was put under pressure by politicians, including Angela Merkel, the right-of-centre German chancellor. Soon afterwards Mr Kleinfeld and his colleagues announced that they would donate their pay rise to a fund to help Siemens workers in trouble.

Compared with their American peers, European companies have been slow to restructure. Mr Kleinfeld's story offers one reason why. It takes courage to stand up to the unions, the press and the politicians, all of whom resist commercial change, however inevitable in the long run. Mr Kleinfeld deserved a pat on the back, but was instead publicly pilloried and obliged to give up a pay rise. With that example before him, what will a sensible German manager do next time he faces a difficult decision?

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Better pay for all

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Jonas Bergstrand

What to change and what to leave well alone

Get article background

ARGUMENTS about executive pay come in two flavours. Economic liberals wary of government intervention reckon that, in spite of some unforgivable transgressions, the system broadly works. Activists seeking a general overhaul of corporate governance have hitched their campaign to pay and tend to say that violations are rife. On the whole, the public agrees with the activists.

This report has, with reservations, sided with the liberals. Most—but not all—of the money that companies have spent on executive pay has represented the price of attracting and motivating the best managers. This has often been obscured by the politics of pay, and by some sensational abuses. Pay has risen largely because of shifts in the market for executive talent, which are part of a more general transfer of rewards to high achievers in many professions.

The strategic decision in America to motivate managers as capitalists, using equity-based long-term incentives, was right in principle and has been widely copied across the world. Too many options were granted during the bull market, mainly thanks to an excess of euphoria and, in America, a misconceived accounting policy that has since been put right. Investors constantly face the risk that boards will make a bad job of looking after their money and fail to stand up to powerful chief executives, and sometimes boards succumb, but this is less of a danger than it was. Over the past 15 years, the managers attracted and kept in place by fat pay packets have led companies through a roller-coaster ride that has been enormously profitable for their investors.

So much for the analysis. When it comes to prescriptions, however, the activists have the stronger case. Where misgovernance has distorted pay, it should be put right. Even though the over-issuance of options was not an abuse perpetrated by the executives themselves, it was a costly mistake all the same. Boards ought to have realised what they were giving away. In addition, better governance is one way to minimise the egregious examples of excessive pay that attract wide attention and spread the belief that all companies pay their top executives too much. If that helps to restore the poor image of business leaders, so much the better.

Reform could also help to fill a vacuum at the heart of the company, especially in America. The big question in the debate about pay remains today what it was when KKR launched its raid on RJR Nabisco all those years ago. How do you get owners to act as stewards so that boards and managers will act in the best interest of owners? A former editor of *The Economist* defined the problem in a special report 17 years ago:

> To shareholders in a typical company in America or Britain—call it Anglo-Saxon Inc—a share is now little more than a betting slip. It is bought at what a shareholder thinks are good odds, to provide winnings that he hopes will be large. The notion that he owns part of Anglo-Saxon Inc makes as much sense to him as it would for the average gambler to imagine that he owns part of Lucky Lady running in the 2.30 tomorrow afternoon. A title deed to a house tells an American or Briton what he knows instinctively: that he owns the place, and must care for it. A share certificate tells him nothing more than that he has the right to a dividend and the chance to make some cash.

Since those days power has shifted in the boardroom, but the vacuum remains. “We have established the idea that the CEO is accountable to the board,” says Mercer's David Nadler. “But who are the board accountable to?”

In the 1980s raiders like KKR showed up the shortcomings of companies. Private-equity groups—the raiders of today—still do. Private equity has blossomed since those early times. Whereas 20 years ago a handful of private-equity firms (including KKR) managed $1 billion in assets between them, today 2,700 firms manage $500 billion. Indeed, private equity has attracted so much capital that some think it is in the midst of a bubble.

Learning from leverage

The explanations put forward for the success of private-equity groups include cheap capital, asset stripping, collusion in chasing deals, “financial engineering” and a leveraged bet on rising stockmarkets. No doubt some of these have played a part, but so has what Richard Holden of MIT's Sloan School calls “governance arbitrage”. The boards of companies owned by private-equity groups are staffed by knowledgeable and highly motivated directors from the fund who have a lot at stake. Managers and directors are all working towards the same medium-term goal of listing or selling a company that will fetch a good price because it is seen to have a long-term future. The arrangement is relatively free of ambiguities about purpose, and there is less temptation either to chase short-term results or to use the very long term as a sentimental excuse for indulgence.

Central to all this is private equity's way of attracting first-rate executives and then motivating and monitoring them. Pay in private equity can rival or exceed pay in even the largest listed company, but it is also more geared toward success or failure. A manager in a really successful deal might earn $50m-70m. One consultant cites the example of an executive in Norway who earned ten times as much in private equity as he had been getting in his listed company. With incentives like that, it is no wonder that European private-equity managers have the stomach to restructure businesses which executives of listed companies leave alone.

But to earn such sums, private-equity managers have to bear far more risk than their counterparts in public companies do. Each group has its own formula, but at Sentinel Capital Partners in New York, as at almost all such groups, the partners require their managers to put in their own money as a token of their commitment. Up to 15% of a company's equity is available for the top managers. They get paid a third of that if they last at the company until the fund sells out. Another third comes their way if the fund earns three times its investment, and the remaining third when it earns five times its investment. In addition, Sentinel's managers earn a basic salary and a bonus structured to reward profit growth and balance-sheet management.

The firms tend to be ruthlessly pragmatic. If something has gone wrong but they retain faith in the manager, they will review the options package, says Sentinel's David Lobel. In private equity the idea is not to be “fair” but to get the best out of executives. On the other hand if a venture fails then a manager will suffer along with the fund. “You don't lose your house,” says one consultant. “But you do lose your summer house.”

Private equity not only pays executives more, it also monitors them more carefully. The boards of the companies it invests in are small, with around six directors, compared with 12 or 13 for a typical listed company in America. Directors bring business expertise and are highly motivated because their careers, as well as their own bonuses, depend upon their investments doing well. Public-company managers often say that directors should keep their distance: the board's job is to govern, not manage. Not so with private-equity boards. Directors are intensely involved and board meetings are generally far more constructive because of that.

The directors of private-equity boards also try to find out as much as possible about the company's inner workings. One academic who had previously been in private equity recalls how when he sat on boards his task was quietly to befriend the finance director. It was one way of reducing the private-equity firm's dependence on the chief executive.

Clearly working for private equity is different from managing a quoted company. Everyone is thinking about the sale of the business; the company is in transition; there is a greater appetite for risk, and probably a greater tendency to rate success in purely financial terms. Yet, at some level, private equity is setting out to attract managerial talent and to give it incentives and monitor its performance, just as public companies do. To that extent, private equity holds lessons for public companies.

Risks and rewards

One concerns the question of how much risk to load on to executives. Private equity strikes a different trade-off between success and failure from that in most public companies. The rewards for success are greater, but so are the consequences of failure. Public companies assume that the sort of people they want to attract as managers need the security of the basic packages they offer. But private-equity firms have successfully bought, taken private and transformed so many quoted companies that the public markets must be missing an opportunity. In Britain Cable & Wireless, a troubled telecoms company, last year overcame investors' squeamishness and gave its executives private-equity-like pay packages that could make them extremely rich—but only if the company succeeds. More companies should be willing to experiment in this way.

The experience of private equity also suggests that the managerial-power theorists are on to something. Managers do better when they are held to account. Overmighty chief executives who combine the role with the chairmanship

would do better if they had to answer to someone. In America, home of the mightiest executives, this is gradually changing. According to the Conference Board, a business-research organisation, some 57% of American chief executives are also chairman of their company, but the share is falling. Almost half of those who fill both roles are watched over by a “lead director”, a sort of non-executive chairman. American managers are imbued with the notion that to concede to directors is to invite meddling, but Josh Lerner, of Harvard Business School, thinks that private equity demonstrates the benefits of involvement. “Intensive oversight is good for companies,” he says. “In an ideal world we would see boards behave more like private equity.”

Punters and proprietors

That is hard when the board has been assembled with a nod to tokenism and an eye to the star-quality of its directors, not their business acumen; or when the directors do not have a financial interest in the company. It is also hard when board directors have to spend so much time complying with regulations rather than rolling up their sleeves and discussing the details of the business. A consultant recalls how one board in crisis that he was advising had to have three sets of lawyers at each meeting, one for the managers, one for the directors and one for a board committee.

Martin Lipton, a corporate lawyer based in New York, recently questioned whether “the institution of the corporate board of directors, as we know it today, can survive as the governing institution of the public corporation.” Mr Lipton lamented the burden of compliance and the ubiquity of lawyers, auditors and consultants. But his special scorn was reserved for the shareholders, whom he accused of seizing control of the corporation.

Mr Lipton is probably right about compliance, but the working of private-equity boards suggests that he is wrong about shareholder power. Close links between directors and owners make a board stronger. Yet it is only a mild exaggeration to say that relations between American shareholders and their boards are conducted chiefly through lawsuits and proxy fights. Campaigning shareholders, such as the American Federation of State, County and Municipal Employees, represent organised labour and other “special interests” (meaning anti-business interests as far as companies are concerned). Other fund managers tend not to mount campaigns against management. The suspicion is that they fear companies will punish them—by withholding information from their analysts or even, some allege, steering corporate pension-fund money elsewhere.

Jonas Bergstrand

Direct contact between independent directors and investors is increasing, but it is still too rare, perhaps because boards are worried about breaking the rule that one group of investors must not receive more information than the rest. Rare, too, are the companies that submit executive pay to a vote or allow shareholders to vote down a director (in most companies, all the No votes are “withheld”, meaning that they do not outweigh a single Yes vote).

Fortunately this is beginning to change as a number of big companies such as Intel and Pfizer have switched to a majority-voting system for directors. Charles Elson, a professor at the University of Delaware, thinks that other companies will eventually follow this lead, which could open the way to votes on the membership of the compensation committee and possibly an advisory vote on pay itself.

This cannot happen soon enough. Shareholders of British companies gained such a vote over pay in 2002. Since a showdown in 2003 over the golden farewell of Jean-Pierre Garnier, chief executive of GlaxoSmithKline, the system has worked well, largely drawing the sting of the pay debate. Objections to executives' pay are mostly sorted out in negotiations with investors' groups, such as the Association of British Insurers, well before any confrontation at the annual meeting—though that threat is always there. American managers fear that votes will give activists too much say. More likely, institutional investors will at last begin to play their part.

The hope is that legislation can be avoided. Pay is all about detail and matching the package to the company. “Certain practices are universally inappropriate,” says Dan Ryterband of Frederic W. Cook, a pay consultancy, “but not many.” That makes pay singularly ill-suited to broad laws banning this or mandating that. The best legislation would therefore simply close loopholes and straighten out distortions, such as America's $1m salary cap and France's bias towards options, and set out standards of transparency.

Companies everywhere urgently need to take steps to ensure that top executives' pay is seen as fair and deserved. That means opening it up to scrutiny and giving investors votes, rather than erecting barricades as if to hide some guilty secret. The standing of business itself is at stake.

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Unrepentant Nardelli

Jan 18th 2007
From The Economist print edition

GE's golden legacy

Jonas Bergstrand

Get article background

IN JUNE last year Home Depot was facing questions from investors about the pay of its chief executive. Robert Nardelli was the only director to turn up at the annual meeting, but refused to discuss his pay. That was remarkably arrogant, considering that Mr Nardelli had been paid something like $125m since landing the top job in 2000 but the share price had fallen by 12%.

This month Mr Nardelli paid for his conduct with his job even though by some measures he had done well at Home Depot. In the year leading up to the furore, the retailer had enjoyed record earnings per share, record gross and operating margins and record sales. Even so, ISS, a consultancy, complained of a “disconnect” between pay and performance. Shareholders seemed to agree: at least 30% of votes at the annual meeting were withheld from ten of the 11 directors on the ticket. As activist investors circled amid continuing criticism of Mr Nardelli's pay, the board decided he had to go—though not without a severance package worth over $200m.

Mr Nardelli's defenestration offers three lessons about pay. First, deals struck in a bull market can look foolish when the bull run stops. Home Depot agreed on Mr Nardelli's contract before the collapse of WorldCom and Enron. Mr Nardelli, a runner-up in the race to lead General Electric (GE), was a catch. But what in 2000 was merely a generous package looked irresponsible in 2006.

Even so, Home Depot might have got away with it had it not made the mistake of treating its shareholders with disdain. After the meeting it was forced to concede that shareholders should have a majority vote on who should be a director.

The third lesson, about Mr Nardelli and GE, puts his salary in a more positive light. One study of the management powerhouse found that the appointment of 20 GE executives as chairmen of other companies between 1989 and 2001 led to an immediate share-price gain averaging $1.1 billion. Mr Nardelli did much better than that, instantly boosting Home Depot's share price by almost $10 billion. Private-equity firms appear to hold GE in similarly high regard. Last summer one of them enticed David Calhoun away from the company to run VNU, a Dutch-based media group with a tenth of the sales of the division he had been running. Reportedly, Mr Calhoun stands to make some $100m from taking it public.

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BP

Paying the price

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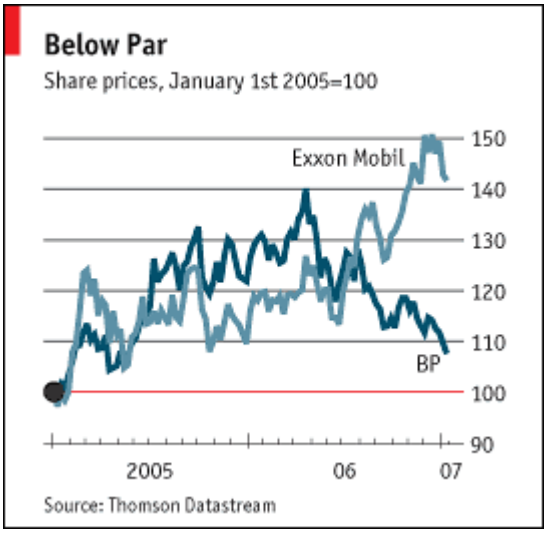
Getty Images

The British oil firm is in trouble. But its rivals face many of the same problems

NO ONE calls upon James Baker, an American elder statesman, to solve a trivial problem. George Bush recruited him to defend his interests in Florida during the disputed election of 2000, and more recently to examine ways out of America's morass in Iraq. The United Nations once asked him to settle a 30-year-old conflict in Africa. So it says a lot about the state of BP, a big British oil firm, that it asked Mr Baker to head a panel to assess flaws in its safety regime.

John Browne, BP's boss, turned to Mr Baker in 2005 after an explosion at one of the firm's American refineries killed 15 people and injured 170 more. Since then BP has suffered a series of further disasters. Last year several of its pipelines in Alaska sprang leaks, briefly forcing the closure of America's biggest oil field and prompting oil prices to jump. BP's trading arm is under investigation for price-fixing. A showcase project at the Thunder Horse oilfield in the Gulf of Mexico has been delayed by a mix of hurricanes and engineering. Last year BP's output declined, and its share price has lagged behind that of rivals such as America's Exxon Mobil (see chart).

Now Mr Baker's panel, which published its findings on January 16th, has determined that BP's management did not devote enough money or effort to ensuring safety at its American refineries. Shortly beforehand, Lord Browne had said that he would bring forward his retirement by 17 months, to the end of July, reinforcing the notion that something had gone badly wrong at BP and that a fresh start was needed to set the firm to rights.



There certainly seems to have been something wrong with BP's safety practices. Mr Baker's report deliberately refrained from assigning blame for the explosion at the refinery, in the small American town of Texas City. But it did argue that the firm placed too much emphasis on preventing personal accidents, such as falls and car crashes, and not enough on preventing operational and engineering failures. Although the panel did not find any evidence that the firm had knowingly skimped on safety, it concluded that budgets had been inadequate and that staff had been overstretched. Moreover, it placed much of the blame for all this on the board and senior managers.

Lord Browne immediately vowed to fulfil all of the panel's ten recommendations. At the same time, he pointed out that BP had already increased spending on maintenance and safety at its five American refineries, from $1.2 billion a year to $1.7 billion. It has also hired more staff, established a new unit to set and enforce safety standards

throughout the firm and beefed up the role of its American operations head to include overseeing safety.

Similarly, BP is doing public penance for its failings in Alaska. It has hired three experts on corrosion to assess whether it is monitoring and maintaining its pipelines properly. In response to allegations that it gave whistleblowers short shrift when they pointed to penny-pinching, it has appointed a former judge as an ombudsman, to record and investigate complaints.

Lord Browne insists that there is no pattern to BP's various problems and no over-arching failure of management. Not everyone agrees: Tony Hayward, his successor, said last year that BP's top brass were too imperious and failed to heed the concerns of the lower ranks. Other observers think the management is not assertive enough. Neil McMahon of Sanford Bernstein, a financial-services firm, believes that BP needs to be reorganised to reduce the autonomy of its many units and so ensure more consistent standards and policies.

But for all the fuss, BP's conduct is probably not too different from that of its rivals. Mr Baker's report suggested that most American oil firms probably tolerated similar safety lapses. Fadel Gheit of Oppenheimer, another financial-services firm, points out that before the disaster at Texas City, many refineries used to keep staff and maintenance crews on site, dangerously close to volatile chemicals. By the same token, he says, none of BP's partners in the Alaskan pipeline complained that it was spending too little on maintenance.

If anything, Mr Gheit argues, BP has handled disaster better than its rivals might have done: it has offered to settle all lawsuits arising from the explosion at Texas City and has set aside $1.6 billion to compensate the victims, whereas Exxon Mobil is still fighting a court case related to the massive spill from the *Valdez*, one of its tankers, off the coast of Alaska in 1989.

The rest of BP's difficulties are hardly unique. BP's rivals are also struggling to increase production, since nationalistic governments are increasingly inclined to exclude Western firms from the most promising exploration prospects. Indeed, BP is in a better position than most, in that it is still clinging to its prolific Russian joint venture, TNK-BP, despite the Kremlin's growing hostility to foreign investment in oil and gas projects.

Likewise, the whole industry is experiencing embarrassing delays and cost over-runs with complex projects like Thunder Horse. That is thanks to the high oil price, which has prompted a boom in exploration and thus created a shortage of labour and equipment. Both Royal Dutch Shell and Exxon Mobil, for example, have increased budgets and stretched timetables for their respective developments on Russia's Sakhalin Island.

Mr Hayward's elevation will not change any of this. As head of BP's exploration and production, he presumably would already be finding and pumping more oil and gas if he could. Furthermore, he has spent his entire career at BP, much of it as Lord Browne's protégé, so he is steeped in its culture. The change of guard may prompt investors to reassess the firm and give its share price a corresponding boost, say analysts. But in the long run Mr Hayward will probably find the job even more gruelling than Lord Browne did.

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American retailing

Fashion victim

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Gap has fallen behind its rivals. Can the fashion chain become trendy again?

“IT is very easy to go wrong in fashion,” says Howard Davidowitz, a retail consultant. Gap, a fashion retailer that was once one of corporate America's shining success stories, used to get everything right. Its affordable, trendy clothes epitomised casual cool. But not any more. The company's production cycles are too slow to keep pace with rivals, prices have risen and the brand has lost its shine. In 29 of the past 31 months Gap reported flat or declining same-store sales. Senior executives are quitting in droves. Profit margins, at 6.5%, are about half the industry's average. In December, traditionally the busiest month for shopping, same-store sales were 8% lower than in December 2005. Gap is now said to have hired Goldman Sachs, an investment bank, to evaluate its options.

This is not the first crisis at Gap. In 2002 Donald and Doris Fisher, who founded the clothes chain in 1969 in San Francisco, fired Mickey Drexler, who had been with them for almost two decades and had made Gap into America's biggest fashion retailer. In 1983 he took over Banana Republic, a maker of pricier clothes than Gap's laid-back T-shirts, sweatshirts, jeans and other basics. Eleven years later he launched Old Navy, a low-cost chain that became the first fashion retailer to reach $1 billion in sales in less than four years. But Gap and Old Navy stumbled badly in 2000. Sales slumped as Gap alienated its main clientele (twenty- and thirtysomethings) while it unsuccessfully chased teenagers. In 2001 the company lost $25m.

The Fishers replaced Mr Drexler with Paul Pressler, a former Disney executive without any experience in fashion. “He was good at fixing the infrastructure and the finances of the business,” says Paul Lejuez, a retail analyst at CSFB, an investment bank. He has closed underperforming shops, reduced inventory and trimmed debt. He also launched Forth & Towne, a chain for women over 35, and Piperlime, an online shoe shop. But what Gap needs now, says Mr Lejuez, is a fashion genius to make the clothes appealing again.

Analysts think a change at the top is the most likely outcome of the review. The consensus is that a new boss should close more of the group's 3,100 shops, reduce its nine-month lead time for new clothes and bring in new talent. Last time Gap was in trouble, all it took was a single campaign, called “Crazy Stripes”, to rebuild its fashion status.

Another possibility would be for Gap's ageing founders, who still own 37% of the group, to sell out. Dana Cohen, an analyst at Bank of America, thinks private-equity firms would be the most likely buyers, as few companies in the trade could swallow Gap. Alternatively, one of the group's three major brands could be sold. The trouble is that both Gap and Old Navy would sell at a discount because of their troubles, and the Fishers are unlikely to want to divest Banana Republic, their only healthy brand.

Mr Davidowitz thinks Mr Pressler will have to go because he has lost all credibility. He thinks the company's owners should reinstate Mr Drexler, who took the top job at J. Crew, an ailing retailer, four years ago and successfully transformed it into a smarter version of Banana Republic. J. Crew is part-owned by Texas Pacific, a private-equity firm and one of the potential buyers if Gap were put up for sale.

Emanuel Weintraub, a management consultant, reckons Allen Questrom is the man for the job. Mr Questrom ran Neiman Marcus, a posh retailer, in the late 1980s, revived Barney's, another retailer, in the late 1990s, and transformed Federated from bankruptcy into the largest chain of department stores. The fickleness of fashion has one advantage: companies lose their shine very quickly, but stars can be born—and reborn—almost overnight.

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Italian food

Buon appetito

Jan 18th 2007 | COLLECCHIO, PARMA AND REGGIO EMILIA
From The Economist print edition

How Parma's food cluster digested the Parmalat crisis

IT IS not so much a job as a way of life. At around five o'clock every morning Bruno Monica starts filling the vats in the dairy at Consorzio Produttori Latte in Baganzolino, in the flat farmland of the Po Valley a few miles from Parma. For almost 40 years Mr Monica has been a *casaro*, or master cheesemaker, overseeing the making of Parmigiano-Reggiano cheese. The five-man dairy makes nearly 10,000 parmesan wheels a year, accounting for around 360 tonnes of the 120,000 tonnes produced by 500 dairies in a tightly defined area south of the Po, mainly in the provinces of Parma and Reggio Emilia.

Surplus whey from the dairy goes next door to feed 3,000 pigs, the meat from which is cured in hills south of the city. About 170 local firms produce the ruby, sweet-tasting Parma ham; almost 10m hams, each weighing about 8kg, leave the curing cellars every year. Both parmesan cheese and Parma ham are steeped in centuries of tradition, and their production is tightly regulated by certification agencies. So producers were mostly untouched by the collapse of Parmalat, a large milk and beverages group based outside Parma that crashed in December 2003 with a hole of €13.2 billion ($16.2 billion) in its accounts.

But other local firms did experience problems. Barilla, the world's leading pasta-maker with headquarters north of the city, was one of them. “It was terrifying,” remembers Guido Barilla, chairman of the family-owned pasta and bakery group, whose ancestors began making pasta and bread in Parma in the 18th century. “Many thought that we were like Parmalat.” The bitter experience of having to explain that his group had not cooked its books lasted several months, he says. “The Parmalat crisis caused enormous shock and hurt the city's image,” says Elvio Ubaldi, Parma's mayor. “Banks looked with suspicion at local firms and credit was a problem for a while.”

On January 12th Enrico Bondi, Parmalat's chief executive, reached an agreement with Deloitte & Touche under which the accounting firm will pay $149m to settle a case that Parmalat had brought against it. Mr Bondi has accused some 50 firms of helping Parmalat's previous management hide debts and manipulate the company's results. So far Parmalat has received about €650m. Banca Nazionale del Lavoro, a large Italian bank, agreed on December 29th to pay €112m ($148m) to close Parmalat's case against it. Unsettled claims against other firms amount to about €27 billion in Italy and $10 billion in America, and the agreement with Deloitte may put pressure on others to settle, particularly Bank of America and Citigroup.

The lawyers have been busy, but so has Parmalat, which has recovered thanks partly to Mr Bondi's decision to keep the group's complex legal and financial entanglements separate from its operations. When the crisis struck, many people thought Parmalat was finished. “Yet we did not lose one day's production. To have done so would have been fatal,” says Carlo Prevedini, Parmalat's chief operating officer, whose dark hair turned white under the stress of those critical weeks.

Biscuits, snacks, bottled water and tomato sauce have been axed from the product range, foreign divisions have been sold, the number of brands has been reduced from 130 to 40, the workforce has been reduced and Parmalat is profitable once again, with annual sales of about €4 billion. It now focuses on high-margin “functional” products, including milk, yogurt and fruit juices, which include health supplements. This week bottles of Zymil, a type of milk for people with digestive problems, began rattling off a new €8m production line.

This is the latest example of how Parma's food cluster has moved with the times. Rich farming land, fought over for centuries, provides the base for a food-manufacturing industry that employs around 15,000 people in businesses like preserved fruits and vegetables (Parma is a centre for tomato processing), sugar refining, ice cream and frozen foods. But as the food business grew strongly after the second world war, Parma developed an engineering industry specialising in food-processing equipment, which employs about 8,000 people. The machines that fill, pack and label the bottles of Zymil were made by local firms. The arrival in 2005 of the European Food Safety Authority, which is based in Parma, has underlined and reinforced the area's standing in food.

But even with the Parmalat scandal now behind it, Parma is not without its problems. Its markets are mature, so more emphasis is needed on product-development and marketing. The Parmigiano-Reggiano and Parma-ham trademarks require constant defence. And then there are food fads. “The Atkins diet was a nightmare,” observes Mr Barilla, “for the consumer, but also for us.”

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Europe's postal services

Return to sender

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Protectionism hampers the reform of Europe's postal services

THE romantic image of the trusty postman, delivering letters to the farthest-flung corners of the land, makes the reform of postal services a sensitive subject. This is especially true when the impetus for reform comes from the European Union. This month the European Parliament starts work on a directive, drawn up by the European Commission, to remove the last monopolies in postal markets by 2009—the final stage in a slow and laborious liberalisation that began in 1992. Directives in 1997 and 2002 chipped away at the centuries-old monopolies enjoyed by national operators, and the proposed new law will open the whole market to competition by abolishing the "reserved area" on mail weighing less than 50 grams. But although the legislative wheels are in motion, some countries are as sceptical as ever.

The commission says it has deliberately pursued postal liberalisation at a slower pace than other market openings. This is partly due to its technical complexity. Unlike in telecoms, post has no physical network to share. Many countries had to create independent regulators from scratch in order to monitor market access and prices. The size of the heavily unionised postal industry also prompted caution. It employs some 5m people directly and indirectly, and its turnover is roughly 1% of Europe's combined GDP.

But arguably the biggest drag on liberalisation is old-fashioned resistance to open markets, plus a dash of reverence for letter writing. One opponent of the 2009 deadline talks of "a noble industry that we want to protect" and lauds the virtues of pen and paper. All postal operators recognise, however, that the epistolary habit has taken a hit from the internet. With deadening pragmatism, the commission says liberalisation will improve quality and choice and reduce state subsidies.

Countries that have already opened their markets, such as Sweden and Britain, agree. Since Sweden's Posten AB was privatised in 1993, prices for business customers have fallen by 30%, though they have risen for consumers. The postal network has been extended, with new outlets in supermarkets and longer opening hours. Proponents of reform argue that Sweden, which has one of the lowest population densities in the EU, disproves the argument that rural countries cannot both have open markets and provide a standard service for everyone.

But France, Spain, Italy and other countries worry that abolishing the "reserved area" will damage this universal-service obligation. Last month François Loos, France's industry minister, said 2009 was "an indicative date" for competition rather than a firm deadline. A spokesman for PostEurop, a lobby group representing European postal operators, says several countries would prefer a deadline of 2012 at the earliest, with the wholly implausible argument that more time is needed to research the impact of liberalisation.

The commission knows a delaying tactic when it sees one. Operators have had years to prepare for liberalisation. But some countries, such as Greece and Luxembourg, seem to want to protect their national monopolies at any cost. The attitudes of central European countries are more difficult to predict. Their governments supported the liberal services directive, which favoured their mobile, comparatively cheap workforces, but have expressed doubts about opening protected home markets to competition.

Incumbents may have less to fear from competition then they think, however. In countries with open markets, the former monopolists have remained dominant. In Britain the Royal Mail has 96.5% of the market; in Sweden Posten AB has 91.5%. Regulators do not expect big changes in either country. Indeed, some advocates of liberalisation worry that open postal markets will fail to attract new entrants and that eliminating the reserved area will not guarantee competition.

The debate over market opening is an opportunity to find out what people really want from their postal services and a chance to rethink how they work, says Michael Critelli, the boss of Pitney Bowes, a company that makes postal equipment and software. Some people might, for example, choose to have domestic mail delivered to their offices on weekdays, he suggests. But such innovations will happen only if national governments can be discouraged from stamping the commission's proposals "return to sender".

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Japanese telecoms

Change is in the air

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Number portability has boosted competition in mobile telecoms

THE law of unintended consequences certainly works in strange ways. Japan's mobile-phone industry is experiencing a bout of unprecedented competition—but not for the reasons most people expected. Something called "mobile number portability" was introduced in October, making Japan the last of the developed nations to let its citizens keep their mobile-phone numbers when they switch from one operator to another. As elsewhere, the aim was to encourage competition and reduce prices by giving users more choice.

In Japan, however, number portability has done little to get people to switch to rival operators and reduce their monthly bills. Instead, the fear of losing customers and revenues has sent the whole industry into a frenzy of innovation, with fancy new handsets and services bombarding the market. Though it is still early days, the number of mobile-phone users in Japan taking advantage of their new-found freedom is surprisingly small. According to government figures, just over 1m subscribers—out of a total of 100m—have switched so far. In other countries where number portability has been introduced, in contrast, annualised "churn" rates can be as high as 50%.

Japan's low churn rate has several causes. For one thing, subscribers who switch can take their phone numbers with them, but not their associated e-mail addresses. In Japan, that is a big snag. NTT DoCoMo, the leading mobile operator with 55% of the market, pioneered mobile internet access in 1999, and today many subscribers rely on their phones as much for e-mail as for voice calls.

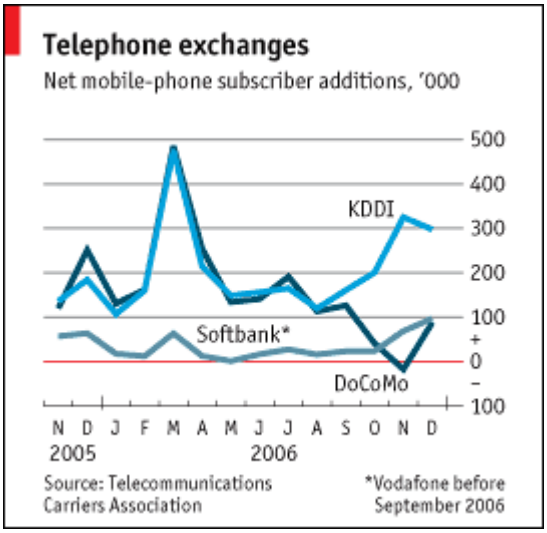
Switching operators also costs money: anything up to ¥10,000 ($83), plus the cost of a new handset, since Japanese handsets are network-specific. Alastair Brydon of Analysys Research, a telecoms consultancy, points out that low churn rates are only to be expected in countries such as Finland and Japan, where operators are either forbidden or discouraged from subsidising the cost of handsets. In countries where handset subsidies abound, switching phones (and operators) is much less costly, so churn rates are higher.

Worse still, subscribers in Japan must approach their existing operator to prise their account loose before signing up with a rival. To their credit, Japan's three big operators—DoCoMo, KDDI and Softbank, which bought Vodafone's Japanese unit last year—have worked hard to make porting numbers speedy, if not painless. Most accounts can be switched within a day or two. But it is made abundantly clear to switchers that many of their favourite services—such as downloadable games, mobile-TV services or payment systems—may not be available on a rival network.

Operators are also offering incentives to discourage subscribers from defecting. Loyalty schemes have been beefed up, with bigger discounts for heavier phone usage. And new handsets have suddenly appeared in all kinds of shapes, sizes and colours. Softbank, despite having only 16.3% of the market, rolled out 16 new handsets when number portability came into effect. DoCoMo introduced nine new models and unveiled nine more on January 16th, one of them scented, and another with a touch screen. KDDI also launched 10 new handsets this week.

Services have improved, too. KDDI, the industry's number two, with 28.7% of the market, has strengthened its downloadable music, mobile-TV and entertainment offerings. DoCoMo, hitherto weak on music and location-based services, has added such features to its pricier handsets and done deals with broadcasters to stream television to its subscribers' phones.

KDDI seems to have benefited the most from the upheaval (see chart). It added 2.5m new subscribers last year, largely as a result of measures introduced to counter number portability. But Gerhard Fasol of Eurotechnology Japan, a consultancy, expects the industry as a whole to benefit. Japanese users may not be paying less for their mobile-phone services but, thanks to portability, they are getting a whole lot more for their money.



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Face value

Bill Gates's other chief executive

Jan 18th 2007
From The Economist print edition

Patty Stonesifer is steering the Bill and Melinda Gates Foundation as it enters uncharted waters

Bill and Melinda Gates Foundation

BEING called “incredibly disingenuous” by the *Huffington Post*, an influential blog, cannot have been how Patty Stonesifer expected to mark her tenth anniversary in charge of Bill Gates's efforts to make the world a better place. But these are strange times for the chief executive of the Bill and Melinda Gates Foundation, a charitable institution accustomed to being showered with praise. Two recent articles in the *Los Angeles Times* accused the foundation—the world's wealthiest, with assets of $32 billion—of profiting from investments in companies whose activities contribute to the very problems the foundation is trying to solve (poverty, debt, disease and so on). This prompted an avalanche of media comment along the lines of “giving with one hand, taking with the other”.

Meeting the straight-talking Ms Stonesifer, it is hard to imagine anyone less disingenuous. This is easily the most hostile press coverage of the foundation in the decade since Mr Gates asked her to take over the day-to-day running of his foundation, shortly after her departure from a senior post at Microsoft, his giant software firm. But, she says, this is the price—a “small price”—that the foundation has to pay for having come so far during that time. “We have become the reference point for all the interesting questions in philanthropy,” she says. And whether a charitable foundation should use its portfolio of assets to reinforce the thrust of its giving—or “mission-related investing”—is, she says, “certainly an interesting debate”.

Many American foundations are jumping on this particular bandwagon, either by screening nasty firms out of their share portfolios, trying to improve bad firms through shareholder activism, or accepting lower financial returns in pursuit of a double or triple bottom line that takes non-financial results into account. But that approach is far too woolly for the Gateses and their philanthropic partner since last summer, Warren Buffett.

In the opinion of the Gates Foundation, Ms Stonesifer explained in a letter to the *Los Angeles Times*, “changes in our investment practices would have little or no impact” on the suffering identified in the articles. The foundation does not own big enough stakes in companies to influence their behaviour through shareholder activism, even if it does nod to political correctness by declining to invest in cigarette firms. A far better way to help people, she concluded, “is by making grants and working with other donors to improve health, reduce poverty and strengthen education.”

Well, maybe. But it will be no surprise if the foundation eventually adopts a softer line, if only to avoid nasty headlines like last week's. That said, pursuing an investment strategy that satisfies the journalists of the *Los Angeles Times* may be impractical, since so few companies would pass muster. The paper's implication that the Gates Foundation benefits from slavery in Africa because it invests in Nestlé and Cadbury Schweppes, for example, requires a particularly outrageous logical stretch.

Evolving to deal with greater than expected complexity has been a central theme of Ms Stonesifer's time as the foundation's chief executive—a role she likens to directing a play written by and starring Mr and Mrs Gates. The foundation has become far bigger and achieved far more than she expected when she took the position, at a time when she was looking to spend more time with her teenage children.

One surprise has been how much time she has to spend evangelising. At first, the foundation thought it could change the world simply by developing things that are desperately needed, such as internet access in libraries and new drugs for malaria and HIV/AIDS. “Bill, Melinda and I were a bunch of product-development people,” says Ms Stonesifer, who was responsible for software including Encarta and Flight Simulator while at Microsoft. “We assumed others would focus on getting the products we developed to those who needed them.” But now the foundation spends a fortune trying to shape public opinion, working with a wide range of partners from governments to companies to churches. Celebrities such as Bono and Oprah Winfrey have become an important part of the foundation's strategy. “Ten years ago, if Bono had asked to meet us, we would probably have said no,” says Ms Stonesifer.

Foundation and empire

The foundation is about to go through another transformation. First, it will grow fast as it seeks to spend the huge gift announced last summer by Mr Buffett. This will double the amount that the foundation has to give away each year, to around $3 billion. Already, one new programme has been launched, on agriculture and financial services for poor people. The staff is expected to double, to the consternation of critics who fear that this will turn the foundation into a stifling bureaucracy. Ms Stonesifer is unfazed by this prospect, having overseen the rapid hiring of thousands of workers during her time at Microsoft—though people who regard Microsoft as bureaucratic may not be reassured.

She is also preparing for Mr Gates to become a full-time worker at his foundation from next year, and for his wife to increase her involvement as well—something Ms Stonesifer calls a “double leadership boost”. She seems genuine in thinking of this as a good thing, and does not expect her own role to be reduced. “Bill does not want to make the trains run on time—that's my job,” she says. “He just wants to do his thing more effectively. Melinda, too.” Ms Stonesifer expects relations with Mr Gates to mimic Microsoft, where Mr Gates is chairman and Steve Ballmer is chief executive. The leadership boost may be coming at just the right time. Whatever the rights and wrongs of mission-related investment, the bad press of the past few weeks may mark a shift for the foundation, into an era when public opinion no longer takes for granted that giving alone is virtuous.

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Microsoft

Peaks, valleys and vistas

Jan 18th 2007
From The Economist print edition

Reuters

The launch of a new version of Microsoft Windows, called Vista, is not quite the event it used to be. Has the software giant reached the pinnacle of its power?

Get article background

AROUND the time of the release of Windows 95, Microsoft discreetly sold a small subsidiary that made its packaging. A decade ago that decision seemed to fit with the progression of computing and the nascent internet. Although people all over the world stood in long lines to be the first to buy boxed and shrink-wrapped copies of Microsoft's latest operating system, it was thought that such products would in future be delivered direct to their computers over high-speed networks.

On January 30th Microsoft releases to consumers the newest version of its operating system, called Windows Vista. Although the company said on January 17th that it would make Vista available for sale and download online, most people will buy the upgrade in old-fashioned boxes, just as they did back in 1995. But this time, despite plenty of razzmatazz, few customers will be queuing up to buy a copy.

This reflects the way in which Microsoft's dominance is slowly being eroded. Who produces the plumbing for a personal computer matters a lot less than it did in 1995. More PCs now talk to one another using open standards rather than proprietary ones. Many services and some programs are accessed online. People watch videos on YouTube, share photos on Flickr, check their e-mail and even work on files and spreadsheets, all using software that is based on the internet.

These changes are bad for Microsoft. Vista is being released with Office 2007, an update to its universally employed suite of word-processing, spreadsheet and other applications. Windows and Office are the backbone of the company. They represent nearly 60% of sales and 80-90% of its profits, estimates Directions on Microsoft, an independent research firm. Close to 1 billion PCs are now in use and because Windows and Office sit on nearly all of them, the programs are the inescapable tithe on belonging to the information society.

The question for Microsoft is whether it can continue to collect these dues. Vista took five years and $6 billion to develop. Some 8,000 people worked on it. Yet it is two years late. A corporate version was released in November—just before the holidays when few firms would install it. This gave Microsoft the chance to complete small bits of ancillary code to make it run smoothly. Most users are expected not to bother upgrading (see article), but to acquire Vista only when they buy a new computer. With hindsight, the release of Vista may mark the moment when Microsoft's Windows and Office are seen as having reached the zenith of their supremacy.

Toppling the software Babel

Computing has changed radically since Microsoft rose to prominence 25 years ago with its operating system for IBM's personal computer. Microsoft unified standards, which made life easier for users and software writers. Both Windows

and Office were employed by software developers as platforms for their own applications, nudging Microsoft further towards ubiquity. Now three trends are changing this.

First is the rise of open-source software. The code for this is written largely by volunteers rather than a single company. The programs are usually free to use and open to continual enhancements. Companies ranging from start-ups to giants like IBM commercialise open-source software by selling services that support it.

As a collaborative venture, open-source can speed up development, make it easier to add features and save users money. The most popular web-server software, Apache, is open-source. So too is the Linux operating system, which is also widely used on servers. Firefox was unknown a few years ago, but now more than one in ten people use it instead of Microsoft's Internet Explorer.

The disadvantage of open-source is that some tedious bits of software development may not get much attention and programs end up a bit geeky. OpenOffice, an open-source version of Microsoft's Office, has been slow to catch on. Versions of Linux for PCs are still cumbersome. But, as Firefox shows, that could change.

The second trend confronting Microsoft comes from online applications and the rise of software as a service. The birth of the PC liberated users from their “dumb terminals” linked to giant mainframe computers. As a stand-alone device, the PC ran on its own software and networking was not important. Today the opposite is true.

More of the things that people want to do with computers now use the internet rather than a hard drive as a source of applications or to store data. So amorphous is the internet that many in the industry refer to it as “the cloud”. Beside e-mail, photograph archiving and music storage, Google and others offer free online word-processing and spreadsheet applications.

Clouds in the sky

For years Microsoft's Windows logo often appeared against a blue sky with cottony clouds. But the cloud has become one of the company's biggest threats. The operating system matters less when programs can be provided online. Moreover, online software can be delivered to customers more cheaply, there is immediate feedback from users and applications can continually be improved. Those are big advantages over software sold in a box, one version at a time.

In the past Microsoft tied its operating system and applications together by “commingling” the code (and ran afoul of antitrust authorities for doing so). The rise of online applications threatens the primacy of Windows because the network becomes the platform for the software. It does not mean PC operating systems are unnecessary, just that it is increasingly the cloud, and not the PC, that is the launch pad for computing.

This suggests new ways to sell software. Instead of charging for each shrink-wrapped box, firms can sell programs as a service, collecting monthly payments, or giving them away and earning money from advertisements.

The third difficulty facing Windows and Office is security. Much of the justification for Vista among Microsoft's managers was to improve security. Governments and large businesses had voiced concern about the omnipresence of Microsoft products and a rash of hacks and viruses that exploited holes in the firm's software.

But there was a big problem. In the past, each new version of Windows was written on top of earlier ones. The code became gangly. It resembled sedimentary rock with the occasional fossil of a long-lost feature or inadvertent vulnerability.

Vista was meant to clean up all this debris. Its code was written from scratch—a large part of the reason for its delay. Yet plans for ambitious new features, such as a powerful way of searching the computer and a new method of storing and retrieving files, called WinFS, were cancelled in 2004 when it became apparent the technology was too difficult. Already behind schedule, Microsoft decided to rush out a release. In December, within days of Vista's being made available to businesses, researchers identified security lapses—even though America's National Security Agency helped to harden it. Are there other vulnerabilities? Nobody will know until Vista is more widely used.

No matter how many resources Microsoft pours into making its software secure, some flaws are inevitable. But the company has also been trying to make security a source of revenue. It established a system ensuring that security updates go only to legitimate buyers rather than those with pirated copies. Yet any insecure PC can harm everyone, because all are vulnerable to one Typhoid Mary.

Microsoft initially planned to prevent other firms' security software from accessing the “kernel” of Vista, in effect the heart of the system. This could render rival products less effective. Although protecting the kernel from malicious code makes sense, some companies argued that it was yet another attempt by Microsoft to use its operating system as the ticket into another market, as it did with browsers and media players. After the European Union complained, Microsoft backed down and provided a form of access.

Although Microsoft is defending itself against some of the biggest trends in computing, it will not be unseated anytime soon. Indeed, the company has often said its biggest competitor is itself: previous versions of its products worked well enough, so many customers would not bother to upgrade to newer ones.

This time Microsoft has put aside any complacency. In the past 18 months the company has reorganised its divisions and put managers from a commercial background in charge instead of their technical colleagues. This counts as a big shift in what was always an engineering culture.

Bill Gates, who as chief software architect was in large part responsible for the earlier, failed vision of Vista, has given up his role. His successor is Ray Ozzie, a relative outsider who joined when Microsoft bought his company in 2005. Mr Ozzie is trying to “webify” Microsoft's products. Greater discipline is expected too. Steve Ballmer, the chief executive, vows that there will be no more long delays between new product introductions.

A little more open

Microsoft is trying to turn threats into advantages. It has responded to the rise of open-source software with both accommodation and demonisation. Last year it struck a deal with an open-source software firm, Novell, to make both companies' products work smoothly together. Microsoft lets big customers inspect its code, but the firm also raises questions about whether open-source programs infringe others' intellectual property.

The company is moving into services with things like Office Live, a set of additional services to help small businesses set up websites, and Windows Live, which provides online features. Microsoft's Hotmail, for example, has recently been rebranded as Windows Live Mail.

Company executives point to Windows Update, which sends updates over the internet, to suggest it has long been in the online-services business. The majority of large businesses buy Windows and Office as multi-year subscriptions with access to all upgrades and support. So Microsoft is at least taking steps in this direction. In the area of online computer games, its Xbox Live service has more than 5m subscribers, suggesting that the company is capable of supplying innovative services.

Chris Capossela, who manages Microsoft's business-products group, believes the firm's “unique” strength is that it straddles both the consumer and business markets at a time when innovations often start at home rather than in the office. Most of the company's competitors, be they Google or Apple on the consumer side, or IBM and Oracle in business, concentrate on only one market.

Microsoft has been written off before, but always remained on an upward trajectory. Its persistence has eventually paid off in some new markets, such as SQL database software and server software, where it started from behind. Its software for mobile devices is also starting to gain traction. Still, in recent years its share price has been steady while the market grew (see chart).

The diffident adolescent that tested the pride and patience of regulators is changing as another generation of employees contribute their ideas. Around 60% of Microsoft's 70,000 employees have been with the company for fewer than six years. For them the past is old history. They joined after the company was found guilty in 2000 of anti-competitive practices and ordered to be split. This was overturned on appeal and a settlement was later reached.

Yet as the importance of the PC operating system declines, it shifts the potential chokehold of computing to the software on the network servers. Here Microsoft is making big strides—and it is where European regulators are concentrating their attention to ensure the company discloses details of its code so that rival products can work alongside it.

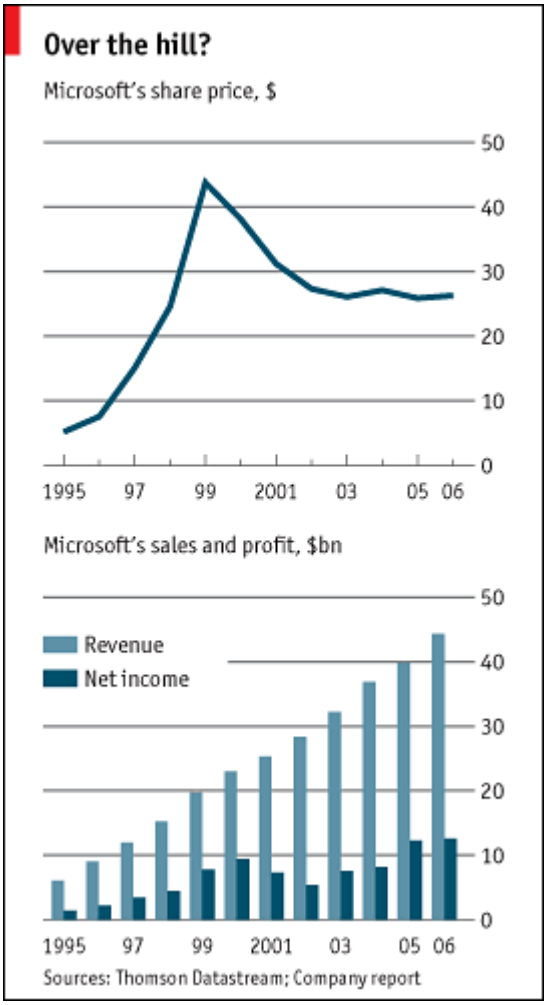
Some observers suggest that Vista and Office 2007 will be the last monolithic software releases—a sort of hangover from the great age of PC computing. Vista should be easier to update online. Nevertheless, Microsoft plans to retain Big-Bang moments to help with its marketing. “We want to have signature events where we can rally the entire industry to what we are doing,” says Mr Capossela.

It is probably impossible to find a pair of products with franchises as lucrative as Windows and Office. Much of Microsoft's activities over the past decade can be seen in the context of trying to diversify away from them. The firm has extended its software into other devices, like television set-top boxes and mobile phones, created (and later sold)

web businesses in travel and media, and moved into new areas. It even launched devices, including the Xbox and its Zune media player—which, despite trailing Apple's iPod, introduced innovations like sharing music wirelessly.

Windows and Office go together like salt and pepper. The question now is whether there will be a decoupling. That could happen if consumers buying a new computer take Windows Vista but decline to buy Office 2007, because they can get similar applications elsewhere, even free. The next step might be for computer-makers to start pushing PCs with Linux rather than Windows installed on them.

Some big companies do have the wealth and talent to remain competitive even as their industry lurches from one incarnation to the next—IBM has done it before, moving from hardware to services. Now its old partner probably has to do the same. The primacy of Windows and Office is waning, even if Microsoft's immediate power is not. “Icebergs melt”, as one Silicon Valley veteran notes. “But they melt extremely slowly.”



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Vista and Office

An end to that blue screen of death?

Jan 18th 2007
From The Economist print edition

AFP

Microsoft's latest upgrades should make PC users happier

Get article background

IT IS an old chestnut, but a telling one: if carmakers built vehicles as Microsoft produces software, they would come in only one colour, the dashboard would be incomprehensible and they would crash a lot. Microsoft's latest products mean that its users should no longer double as crash-test dummies.

The Windows Vista operating system is more compartmentalised, so bits can easily be upgraded. Its 50m lines of code include better security, a sophisticated desktop-search tool and new navigational designs. A feature called “aero”, for example, lets users see small three-dimensional images of active applications. There is also a way to view the contents of files without having to open them. Vista offers “gadgets”—small programs like an alarm clock that float on the screen (Apple calls them “widgets”). Under the surface, Vista provides better document sharing, encryption, parental controls and easier support. Microsoft even slipped in a mechanism to disable pirated copies.

Office 2007 (which includes Word, Excel and PowerPoint in the basic version—users must pay more for Outlook) is also improved. Menus are gone and in their place are tabs and a “ribbon”—a long toolbar above the file. The programs are enhanced: Excel has better visualisation tools to help users spot trends or anomalies. Word lets users see changes before implementing them (a boon, considering one of the most commonly used Word commands is “undo”). Yet the new system takes time to learn. Users of previous versions of Office will need to install free software to read documents in the new file formats.

In many ways, the changes make Microsoft's new software more like Apple's. Yet more flattery for Steve Jobs, the boss of Apple, who has seen more than a decade of Microsoft upgrades that borrow his company's interface innovations. But users have little reason to upgrade immediately: the benefits are largely cosmetic. Besides, Vista requires so much computing power that most people will probably be able to run it only when they buy a new machine.

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University endowments

The ivory trade

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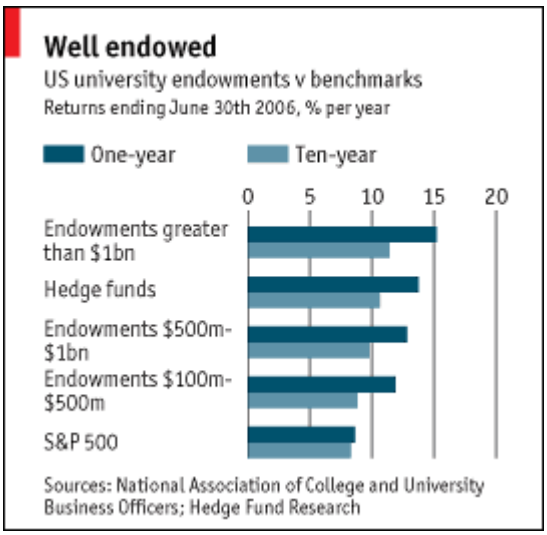
Digital Vision

What makes America's colleges such clever investors?

AMERICA is the home of the efficient-market hypothesis, which says financial markets have become so keenly contested that it is impossible for investors to keep beating them. Yet the very universities that peddle this theory so confidently also gleefully undermine it by doing precisely that: over one year and over ten, their endowment funds beat the S&P 500 and hammer most other institutional investors, including pension funds.

The final figures for the most recent fiscal year will be out next week. But according to preliminary numbers from the National Association of College and University Business Officers (NACUBO) and TIAA-CREF, a financial-services group, university endowments made an average return of 10.7% in the year to June 30th 2006, net of fees and expenses.

The biggest endowments are big investors: between them, Harvard and Yale have some $50 billion, around one-seventh of the total. They tend to do better than their smaller peers and pretty much everyone else. Indeed, these eggheads even beat the quants. Endowments larger than $1 billion returned 15.2% on average last year, more than the main hedge-fund index (see chart). The best-performing endowment in 2005-06, which belonged to the Massachusetts Institute of Technology, gained a handsome 23%. That put it a whisker ahead of Yale's (22.9%), run for more than 20 years by David Swensen.



Endowment managers would no doubt like to claim this is all down to skill. But they do enjoy certain advantages over their rivals. In principle, their investment horizon lasts not weeks, months or years, but forever. Their capital is extremely patient. Each endowment has a single client—itself—that needs to extract only a small sum annually to keep the wheels of scholarship turning. Therefore, unlike pension funds, they do not have to fret about matching assets with liabilities. This means endowments can tolerate lots of volatility, which in turn allows them to make, and stick to, contrarian bets. They have been "incredibly gutsy" in going against the grain, says Will Wechsler of Greenwich Associates, a financial-services consultancy. Perhaps they can stay solvent longer than the market can stay irrational.

A second advantage is the university environment. "Whereas pension trustees are naturally risk-averse, universities are all about innovating, financially as well as intellectually," says James Walsh, who runs Cornell's $5 billion endowment. Investment constraints are kept to a minimum. Alumni with Wall Street experience are encouraged not only to donate money but also to sit on investment committees. Many are happy to oblige. "This gives us access to minds we couldn't otherwise afford," says Mr Walsh. The brainpower on tap at the university itself is not always as useful. According to one former Harvard official, its endowment fund has done so well because it has avoided taking advice from the economics faculty.

Put these factors together, says Mohamed El-Erian, Harvard's endowment chief, and you have a recipe for “thinking more boldly than the pack”. America's endowments were among the first to look beyond the staid mix of domestic equities, bonds and cash. The idea they helped develop in the 1970s and 1980s—deemed eccentric at the time—was to break the portfolio into a mix of standard and “alternative” assets, as uncorrelated with each other as possible so as to spread risk. This strategy is sometimes referred to as “portable alpha”.

Their early moves into hedge funds, venture capital, private equity, property, distressed debt and the like brought outsized profits. Universities and foundations have also benefited from geographical diversification, especially into emerging markets. Foreign equity was their best-performing asset class last year, making 24.7% according to a survey by the Commonfund Institute, which manages pooled investments. Endowments have also revolutionised commodities. By making a killing in “hard” assets like timber in recent years, the universities have helped to turn them from industrial assets to financial ones in investors' eyes. Harvard keeps three lumberjacks on its team, the joke goes.

Sweating as they swot

Indeed, for university endowments to call all of these assets “alternative” is something of a misnomer. It is assets such as government bonds, once safely in the mainstream, that must fight for their place in university portfolios. Today the typical large endowment has 41% of its holdings in assets other than shares, bonds and cash, says NACUBO. In the past couple of decades, illiquid investments, which are less efficiently priced than liquid ones, have rewarded those brave enough to buy them. Thus big, bold endowments have thrived by resisting what John Maynard Keynes—a proponent of asset diversification—called the “fetish of liquidity”.

Will university endowments continue to defy the ivory-tower theorists? Don Fehrs, head of research at Evanston Capital Management, a hedge fund—and a former head of Cornell's endowment—thinks it is becoming harder for them to maintain their advantage because, predictably, copycat investors have piled into areas they once had largely to themselves.

The biggest endowments now employ dozens of bright sparks to look for promising new pastures. Some have even sent scouts to developing countries. Others are hoping to stay ahead by handing large sums to bright but untried managers. They are spending less time on broad asset allocation, and more on trying to pick winners within each class.

This is a trickier exercise, but they may have no choice. Simply putting 20% into hedge funds is no longer enough. The big test of their prowess will come when lax credit conditions tighten. John Griswold of Commonfund thinks that some investment committees, stuffed with alumni, may be starting to lose track of the risks their endowments are taking.

All endowments are finding it harder to hold on to their best people. Although a few high-fliers, such as Mr Swensen, are content to forgo the vast salaries they could earn at private firms—top endowment chiefs rarely get more than $2m a year—many have been tempted away as portable alpha of a different kind.

Harvard, Stanford, Cornell and Duke have all lost their bosses over the past year and a half. After 15 years in the job, Harvard's Jack Meyer tired of the hostility students and professors showed towards his highly paid (and highly successful) managers. He quit and set up a hedge fund, taking more than 30 of his colleagues with him. Stanford's Michael McCaffery left after failing to persuade the university to let him manage private money alongside the endowment. These defections have left quite a few vacancies at the top.

Nevertheless, the endowment model continues to win plaudits—and to attract imitators abroad. As Japan loosens its investment rules, its university presidents are said to be looking very closely at the “Yale model”. In Britain, Cambridge University has persuaded Mr Swensen to sit on the committee overseeing its £1.2 billion ($2.35 billion) central endowment. Despite the resistance of otherworldly dons, it recently became the first British university to hire a City financier to run its fund. The university's vice-chancellor, Alison Richard, was previously provost of Yale, where she gained a “powerful understanding” of what a well run endowment can do. Profits trumping profs on the banks of the Cam: that really would be an investment coup.

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Japanese interest rates

Taking the hint

Jan 18th 2007 | TOKYO
From The Economist print edition

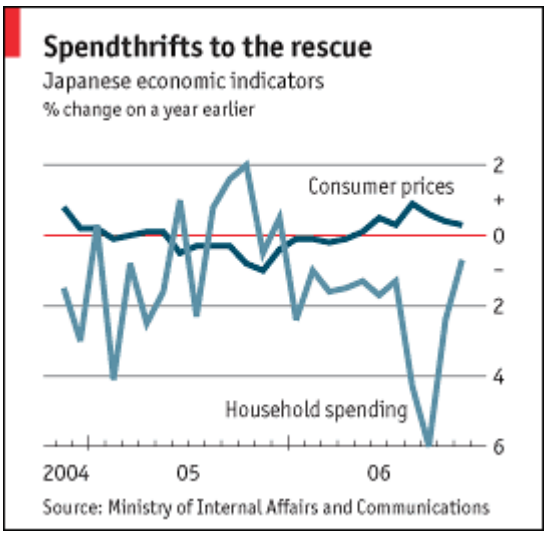
The Bank of Japan does as it is told and sits tight

Get article background

THE first sign that the Bank of Japan (BoJ) was having second thoughts appeared on Wednesday. Bond prices suddenly spiked up, even though the odds were supposedly five to one in favour of the BoJ raising its key rate from 0.25% to 0.5% after its policy board concluded its monthly meeting on January 18th. The word around the watering holes of Nihonbashi, where the BoJ is headquartered, was that the board was about to reverse its decision. Within minutes, the yield on the popular ten-year government bond plunged six basis points (hundredths of a percent), to 1.675%, as traders rushed to cover their excessively bearish positions. On cue, the yen tumbled in currency markets around Asia as it became clear that Toshihiko Fukui, the governor of the Bank of Japan, was about to defy expectations of a rate rise.

Once again, his bank decided discretion was the better part of valour. Having tasted the fruit last July of its first interest-rate rise in almost five years, the BoJ has been keen to have another bite. It came close to raising the unsecured overnight call rate from 0.25% to 0.5% in December, but backed off when enough of the nine-member policy board raised doubts about the strength of the economy's recovery.

On Thursday afternoon the U-turn was confirmed. The policy board, which Mr Fukui chairs, had voted six-to-three to keep the rate at 0.25%—at least until the preliminary GDP figures for the last quarter become available in mid-February. Although the economy continues its expansion, the bank noted, consumer prices and spending had yet to impress (see chart).



What was left unsaid was that there are growing doubts within both the government and the ruling Liberal Democratic Party (LDP) about the bank's central policy. Indeed, the BoJ has been under intense pressure over the past week from the government not to rock the boat. Hiroko Ota, the economic and fiscal-policy minister, called on the BoJ to be “accountable” (code for “watch out”). She said the central bank should “support Japan in its struggle to exit from deflation.” Despite the BoJ's view that deflation is dead, core consumer prices, excluding fresh food and energy-related items, are still falling.

To the government, the idea of raising borrowing costs in these circumstances is out of the question. Hidenao Nakagawa, the powerful secretary-general of the LDP, even threatened to use the government's powers to delay the implementation of a rate rise if the BoJ was rash enough to recommend one. It was not.

With its popularity tumbling, the government of Shinzo Abe is facing a potentially disastrous six months. If Mr Abe and his party lose the upper-house election this coming July, he will be out on his ear. Indeed, pundits are already talking about the post-Abe era. With panic spreading through the LDP ranks, the government is determined to stifle all talk about interest rates. Mortgage rates, politicians note with alarm, are already inching up as the BoJ squeezes the money supply. Indeed, it is raising rates by stealth—the overnight call rate is around 0.3%, well above the BoJ's official target of 0.25%. Meanwhile, wages have stagnated and the public has refused to go out and spend.

Warm weather was blamed for the languid winter sales. But retail sales have been sluggish all year. The Cabinet Office's household survey for the year to December (released mischievously while the BoJ's policy board was in session) shows that confidence had slipped further. The government's fear is that the economy's fragile recovery is failing to take hold and recession could return.

Mr Fukui is less fretful and fidgety. As governor, he has shown in the past that he can stick to a long-term, pro-active stance on the economy, rather than allowing the bank to be deflected by every minor setback. His view is that the economy is on the right track—indeed, it is enjoying its longest expansion in decades. Admittedly, most of the growth is coming from the corporate sector, mainly in the form of surging exports (thanks to the weak yen) and

investment in factories and equipment (courtesy of excessively low interest rates). But, in the BoJ's view, the growth in corporate earnings will feed through to Japanese households via fatter bonuses and wage rises. It is only a matter of time.

That is the problem. What Japanese voters are hearing from their employers is that profits may be soaring, but the money is needed for investment rather than frivolous things like higher pay today. Japanese firms are exposed to the full blast of competition from efficient suppliers in low labour-cost countries. That is something which does not seem to have been factored into the BoJ's thinking. It assumes that corporate profits will automatically pass through into wages, letting household spending take up the economic running. But thanks to the punishing effects of globalisation, this central plank of its policy looks a little shaky.

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Buttonwood

Road runners

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From The Economist print edition

The popularity of infrastructure investing

WHEN the Pennsylvania turnpike opened on October 1st 1940, motorists queued for hours to travel on what was called “America's first superhighway”. Now investors are waiting in line for the toll road, which may become the next bit of American infrastructure to be privatised. Forty-eight firms expressed an interest in leasing the road, after Governor Ed Rendell floated the idea.

Unusually, America is catching up with a trend that was pioneered elsewhere—in this case as far away as Australia. Infrastructure has become the most fashionable of asset classes, as governments desperate for cash link up with pension funds desperate to diversify out of shares and bonds.

Some big deals have already been done: Indiana got $3.9 billion for a 75-year road lease last June, and Chicago earned $1.8 billion for the 99-year lease of its skyway, which runs for less than eight miles (13km). Investors are just as eager to buy whole companies as they are to back single projects: witness the £10.3 billion ($19.2 billion) takeover by Ferrovial, a Spanish construction firm, of BAA, which runs Britain's biggest airports, and the £8 billion purchase of Thames Water, a British utility, by Macquarie, an Australian investment bank.

But this frenzy of activity is causing some alarm. Michael Wilkins of Standard & Poor's, a rating agency, gave warning last year: “The infrastructure sector is in danger of suffering from the dual curse of overvaluation and excessive leverage—the classic symptoms of an asset bubble.” He estimated that $100 billion-150 billion of capital was raised last year to invest in infrastructure. As money pours into the industry, prices are going up and future returns are being revised down.

Why are investors so keen? Part of the reason is that pension funds have changed their behaviour, to seek out assets that match their liabilities. Infrastructure assets look ideal, because they are long-term with revenues that tend to be linked to inflation. Because deals are made with governments, they look safe.

They also supply an income. The pension fund of John Lewis Partnership, a British retailer, invested £25m in an infrastructure fund last year. Its investment manager, Andrew Chapman, said, “We see infrastructure as somewhere between equities and bonds: some growth prospects and a very good running yield.”

Infrastructure assets have also attracted private-equity groups. “They like the predictable cashflows, the limited competition, high barriers to entry and regulatory protection,” says Mr Wilkins.

But that creates another doubt. The model championed by Macquarie, one of the leaders in the field, is to treat infrastructure as a 25- to 30-year investment. That, claims Macquarie, gives it an incentive to undertake capital expenditure, since it has a prospect of earning a decent return over the long term. Private-equity groups do not look that far ahead. “They are looking for a three- to five-year holding period, at most,” says Mr Wilkins. That makes capital-expenditure programmes look unattractive.

In the short term, the surge of money does seem to be making deals look riskier. Moody's, another rating agency, says that the average rating of toll-road debt has declined by five grades since 2001. But perhaps the surge of investor demand will be counteracted by a wave of supply from governments. The idea of privatising is probably most deeply embedded in Britain and Australia. The growing acceptance of the concept in America is opening a huge new market. And Merrill Lynch projects that infrastructure spending in emerging markets could exceed $1 trillion in the next three years—$400 billion in China, $110 billion in India, $185 billion in Russia and $150 billion in the Middle East.

The trouble is that investing in Britain, America and Australia, where regulatory regimes are clear and predictable, may prove easier than venturing into some developing countries. Subsidiaries of Suez, a French utility group, eventually lost water contracts in Argentina and Bolivia after facing stormy political opposition to tariff increases. Venezuela is planning to nationalise its biggest electricity group, now majority-owned by AES, an American power company.

Furthermore, the trade-off between the risks and rewards of investing in utilities can be skewed. As investors in

Britain have found, high returns in one period cause the regulator to adjust his calculations for the next, so that the upside is capped whereas the downside is not.

Even in the rich world, infrastructure assets can come unstuck. Take a transport project blessed with a 55-year lease (at the outset) and a service that slashed the travel time between two historic capital cities, much loved by tourists. Does that sound like a sure-fire investment? Alas, the proprietor, Eurotunnel, filed last year for the French equivalent of Chapter 11.

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Sustainable investment

Analyse this

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Investors broaden their horizons

WHAT do they know of money, who only money know? Some investors are deciding that successful stock-picking is about more than whether a company meets its next quarterly profits target.

The trend was exemplified on January 15th when AXA, the French insurance giant, became the latest big investor to sign up to the Enhanced Analytics Initiative (EAI). The idea behind this initiative, which is over two years old, is that members agree to use part of their budget to reward brokers that publish research on extra-financial issues such as climate change or brand management. With the recruitment of AXA, the initiative's members control some $2.4 trillion of assets.

The EAI can be lumped in with lots of other movements under the heading of “sustainable investing”. The subject generates great cynicism, with critics suggesting investors are in thrall to political correctness and guilty of creating a “box-ticking” culture that stifles entrepreneurship.

One easy target for the cynics is the United Nations Principles for Responsible Investment, which contains such jargon-filled waffle as “we will be active owners and incorporate ESG issues into our ownership policies and practices.” Investors with some $5 trillion of assets, ranging from ABP, the Dutch pension fund, to Sumitomo Trust of Japan, have signed up.

The field is dogged by inconsistent terminology, with terms such as ethical and socially responsible investing also widely used. But broadly speaking, three forces are at work: corporate governance, which deals with matters such as shareholders' rights and executive pay; ethics, which can cover boycotts of industries or countries and campaigns for better treatment of workers; and the environment.

Most subscribers genuinely believe that companies that behave in the “right” way will produce better long-term returns. Eric Borremans of BNP Paribas Asset Management says that making money and doing the right thing are not “mutually incompatible goals”.

Companies that take ethical or governance shortcuts risk being embroiled in scandals that damage their profitability and mar their brands. This means that sustainable companies need not be obviously green or worthy.

For example, David Blood, a Goldman Sachs veteran who founded Generation Investment Management (with the help of Al Gore, a former American vice-president), cites a previously successful investment in T. Rowe Price, an American fund-management group. He says the group's ethical commitments and its success in motivating staff allowed it to avoid the mutual-fund scandals that hit the industry earlier this decade and so to increase its market share.

Similarly, Hermes, the British pension fund, points to its meetings with Premier Oil, the exploration group, which led to the company's withdrawal from Myanmar and the restructuring of its shares. The company's stock rose by 10% on the news.

Enthusiasts are convinced that just looking at the profit and loss account and the balance sheet is blinkered. Jean-Pierre Hellebuyck of AXA Investment Managers says: “it reduces the risk of an investment once you know a company better.” If they are right—and so far, there is little data to prove it—the research promoted by the EAI will be well worth the price. Its business model might even prove sustainable.

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Private equity

New gates to storm

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Private equity explores more distant frontiers

THE art of private equity, it might be said, is finding and polishing diamonds in the rough. No wonder, then, that more firms are venturing off the beaten path in search of uncut gems. With record sums pouring into the asset class in recent years—the biggest funds have topped $15 billion—more investors and fund managers are turning to the developing world. Just this week Citigroup unveiled plans for a new $200m fund dedicated to Africa.

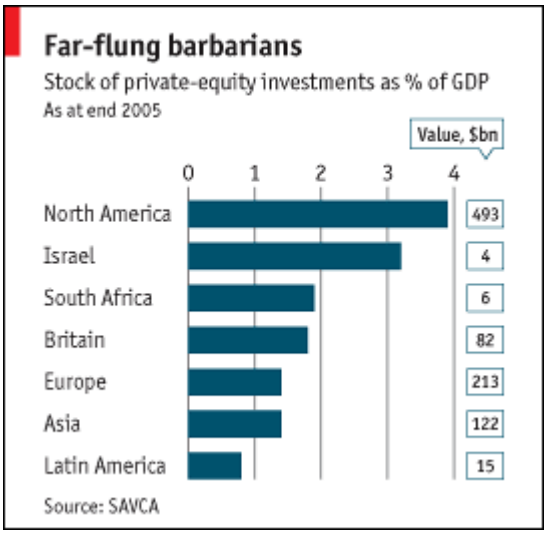
Although America and Europe still attract the lion's share of private-equity investing, emerging markets—from Asia and Africa to Latin America—are rapidly growing. More than $22 billion was raised for these markets in 2006, according to the Emerging Markets Private Equity Association, up from $3.4 billion in 2003. The fastest growth last year was in Africa and the Middle East. A survey of big investors by the association found that 65% plan to increase their commitments to emerging markets in the next five years.

Several things explain their new appeal. Keener competition for deals in America and Europe is prompting funds to look further afield. Economic growth and greater stability have made some countries more attractive than they once were, as has the new maturity of their capital markets. A growing band of companies in the developing world have global ambitions of their own and want to tap into the expertise and networks that foreign investors can offer.

Finally, the rewards in these locales are often much richer than elsewhere. A private-equity index compiled by Cambridge Associates showed an annual return in emerging markets of about 23% over the three years to June 30th. That is more than double the return offered by the Standard & Poor's 500 stock index. Last year, the gap was even bigger: 25% versus 8.6%.

Such pickings are hard to resist and some of the world's biggest private-equity outfits are entering the fray. South Africa's financial circles are abuzz over reports that Blackstone Group, Bain Capital and Kohlberg Kravis Roberts are potential bidders for a retail chain called Edgars Consolidated Stores. Edcon, as it is known, has over 900 stores across southern Africa and a market value of about 19 billion rand ($2.6 billion), which would make it one of Africa's largest private-equity targets. Giants like Texas Pacific Group (TPG) have continued their march across Asia. TPG now has six offices in the region, stretching from China to India. Benchmark Capital, Apax Partners and 3i are among the global firms invested in Israel.

Of course one investor's frontier may be another's backyard. Countries like Israel and South Africa may seem fresh and far-flung to some, but in a private-equity sense they have already emerged. The stock of private-equity investment as a fraction of GDP amounted to 3.2% in Israel and 1.9% in South Africa at the end of 2005, putting them ahead of every region of the world except North America (see chart). These days the true pioneers in the field—investors and fund managers such as CDC, Actis and Acap Partners—are putting money into countries from Afghanistan to Tanzania. In contrast to the mega-deals that have made private equity famous, they target modest investments in outfits ranging from dairies to banana growers.



Even veteran investors warn of the hassles of working in such markets. These can include decrepit infrastructure, poor corporate governance and a limited pool of skilled managers. Governments can turn hostile and currencies can turn against you. The cost of borrowing may also be dearer in emerging markets, making it too expensive for acquiring firms to load up on as much debt as they do elsewhere. It takes longer to turn a company around in emerging markets, veterans say, and at the same time exiting from a deal may be trickier. In particular, initial public offerings are less attractive in countries cursed with illiquid stockmarkets.

Private-equity investors are as demanding in their new stomping grounds as on their home turf. A survey last year by the Tuck School of Business at Dartmouth found that they want to see returns of at least 25% on their investments in emerging economies. The will to venture into frontier markets is strong, it seems, but only if the

gems gleam brightly enough.

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Bank crises

Financial fire-drill

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Regulators and banks should play games together

BANK supervisors and central bankers are less wedded to their mystique than they once were. But they are still coy about revealing how they would react to the threat of a big bank failure. They have been happy to perform public dress rehearsals to test their response to bomb attacks and avian flu. But their simulations of a solvency crisis are still shrouded in secrecy.

In April last year the European Commission ran an exercise in which it pretended a commercial insolvency was threatening to bring down two banks, one of them big. In May the European Central Bank rehearsed the collapse of a large European institution. The British financial authorities also had two drills in the past year, one of which examined the impact on a British clearing bank of the failure in London of a foreign banking subsidiary.

This is progress of a sort, but the authorities' tests have been one-dimensional, excluding all protagonists from the private sector. Some see a need for full-scale war games, to prepare the authorities and top managers for financial crises that threaten a big institution, or worse still, an entire financial category.

Supervisors say they have a good reason for treating banking crises differently. Putting some doubt into bankers' minds—"constructive ambiguity", as the regulators put it—is a guard against moral hazard. If commercial lenders assume the central bank will always bail them out when things go wrong, they may be tempted to lend recklessly.

However, in today's borderless markets that argument has worn thin. The biggest banks, to which regulators apply the ungainly term Large and Complex Financial Institutions (LCFIs), straddle so many markets, in so many countries, that a national authority cannot act alone. It needs to choreograph a joint response with regulators abroad and with the banks' main counterparties, wherever they may be.

Many authorities have signed international memoranda of understanding, promising to exchange information in a crisis. But the actual procedures for co-ordination have barely been spelt out, let alone rehearsed. At the root of this failure is uncertainty about how the burden of a bail-out should be shared between an LCFI's home country and its foreign hosts, where it may have lots of business.

Some regulators are beginning to admit the problem. In November Sir John Gieve, deputy governor of the Bank of England, called for more practical machinery to handle complex cross-border failures, even if this carried the cost of "sacrificing some mystery". His former colleague at the bank, Andrew Gracie, left last month to set up Crisis Management Analytics, which will offer banks and supervisors tailor-made simulations of financial meltdowns. While still at the Old Lady, Mr Gracie led a team that devised several crisis exercises for the British and European authorities. He believes the scope for testing is far wider than most people think.

Nordic regulators are the keenest on financial war games, but so far even they have not included the banks themselves as active participants. "We are moving in that direction," says Göran Lind, an adviser to the Sveriges Riksbank, the Swedish central bank. A rehearsal conducted by the country's regulators in December included in its cast a senior private banker, representing a bank in trouble, whom they could consult for responses as events unfolded. The four Nordic regulators are preparing an exercise for next year to test a cross-border crisis.

The near-collapse of Long-Term Capital Management (LTCM), a hedge fund, in 1998 is still the closest the financial world has come in recent years to a systemic breakdown. The lesson of that near miss is that a combination of supervisors and financial practitioners is the best, and perhaps the only, means of rescue. But supervisors cannot count on the next crisis being as clear-cut as the failure of LTCM. The giant hedge fund had only a dozen or so big counterparties, all of whom were persuaded to sit round a table in New York. Nowadays, a failing institution could have thousands of creditors, with different claims and agendas, not to mention holders of credit insurance keen to push it into insolvency. Simulations might help show whether hedge funds and private-equity firms would step in as (hard-nosed) rescuers, reducing the severity of a crisis. Unfortunately, only the real thing could tell you for sure.

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Economics focus

The great unbundling

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Does economics need a new theory of offshoring?

GLOBALISATION is a big word but an old idea, most economists will say, with a jaded air. The phenomenon has kept the profession's number-crunchers busy, counting the spoils and how they are divided. But it has left the blackboard theorists with relatively little to do. They are confident their traditional models of trade can handle it, even in its latest manifestations. For example, Greg Mankiw, of Harvard University, has concluded that "services offshoring fits comfortably within the intellectual framework of comparative advantage built on the insights of Adam Smith and David Ricardo."

Ricardo illustrated his insights with the example of Portuguese wine trading for English cloth. But some trade theorists think this metaphor will no longer do. Indeed, two of them—Gene Grossman and Esteban Rossi-Hansberg, of Princeton University—published a paper* last year subtitled "It's not wine for cloth anymore" (see "On the hiking trail", August 31st 2006).

Ricardo, it seems, did only half the job. He described the first of two "great unbundlings"—as Richard Baldwin, of the Graduate Institute of International Studies in Geneva, has put it in a recent guide†. Trade in wine, cloth and other goods allows production to be distanced from consumption. Countries do not need to grow grapes to enjoy the fruit of the vine; thanks to trade, they can transform cloth into wine instead.

But in Ricardo's world, a country must still take care of all of the separate tasks required to finish the goods it makes. In a country of pinmakers, to take Adam Smith's seminal example, someone must still cut, draw and straighten the wire; fashion and affix the head; then whiten and sheath the finished product, if any pins are to be made at all.

In the second great unbundling, production is spliced and diced into separate fragments that can be spread around the globe. Pin-whitening is done in one country; wire-cutting in another. Some theorists call this the "vertical disintegration of production across borders". Thankfully, Messrs Grossman and Rossi-Hansberg have a more felicitous phrase: "trade in tasks".

As globalisation has advanced, it has become easier to move some of these tasks offshore. For the workers who once carried them out, this has three possible consequences, two bad, one good. Start with the good news. Offshoring makes firms more productive. The tasks that are best kept close to home remain onshore; other tasks can be taken care of in cheaper places abroad. Everyone benefits from this gain in productivity, including the workers who have fewer tasks to perform. For example, Japanese electronics companies continue to flourish in American markets precisely because they have moved their assembly lines to China.

The second potential consequence of offshoring might be called the "Lou Dobbs effect", after America's most prominent television mercantilist. When some tasks are taken overseas, that leaves less work for patriotic Americans to do, right? Well, maybe. If a whole industry leaves America's shores, demand for labour will ebb, and wages will fall. But in less extreme cases, relieving workers of some of their tasks (wire-cutting for example), allows the domestic industry to expand—and a bigger industry might find room for the displaced wire-cutters, at the same wage, albeit on different tasks.

Offshoring, it is clear, enables companies to make more stuff. But this can be a mixed blessing. If the home industry makes too much, it will depress the price of its exports on world markets, damaging the country's terms of trade, and hurting workers. This result is sometimes called the "terms of trade effect".

Messrs Grossman and Rossi-Hansberg describe this as a "new paradigm", a phrase guaranteed to raise the hackles of more cautious scholars. Their model may not be quite that, but nor does it sit altogether comfortably within trade economists' established way of thinking. That tradition painted in bold strokes, and identified clear winners and losers from globalisation. Economists felt sure they could predict what would be traded and who would get hurt. As Mr Baldwin points out, they made pronouncements about entire "sectors" of the economy (heralding the dawn of some industries; the twilight of others) and whole classes of workers (the college-educated versus the rest) whose fortunes were tied to them.

A bundle of results

The new breed of models paint globalisation with a much finer brush. (It is high-resolution globalisation, Mr Baldwin says.) International competition plays out not just at the level of the industry, or even the firm, but right down at the level of individual tasks—assembly, packaging, data entry—that cut across whole sectors of the economy. Moreover, in a break with most traditional models, the new theories do not take the tradability of things as a given. For Messrs Grossman and Rossi-Hansberg, the ease of trading a particular task is a matter of degree not kind; and it is a variable, not a constant. Hence tasks that seem safe from foreign competition today may not be so tomorrow. Finally, the tradability of a task might bear no relation to the amount of skill it requires. As a result, the victims of globalisation are harder to identify and the salves harder to apply.

So is globalisation to blame for the rich world's recent anxieties or not? Unfortunately, the new theories of offshoring can deliver opposite verdicts depending on precisely how they are set up. As James Markusen, of the University of Colorado, mischievously puts it, “I am confident that I can concoct a model to generate any result desired by a reader with a deep pocketbook.” If only every worker were as versatile.

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* “The Rise of Offshoring”

† “Globalisation: The Great Unbundling(s)”

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Psychology

How grue is your valley?

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Psychologists are learning more about how colour builds language and language builds colour

Corbis

LANGUAGES divide the spectrum up in different ways. Welsh speakers use “gwyrdd” (pronounced “goo-irrrth”) as a general word for green. Yet “grass” literally translates as “blue straw”. That is because the Welsh word for blue (“glas”) can accommodate all shades of green. English-speaking anthropologists affectionately squish “green” and “blue” together to call Welsh an example of a “grue” language. A few of them think grue languages are spoken by societies that live up mountains or near the equator because ultraviolet radiation, which is stronger in such places, causes a progressive yellowing of the lens. This, the theory goes, makes the eye less sensitive to short wavelengths (those that correspond to the green and blue parts of the spectrum). Unfortunately, though the Welsh do live in a hilly country, it is hardly mountainous enough—let alone sunny enough—to qualify.

The ultraviolet theory, however, is just one idea among many in the debate about the psychology of colour. Like many debates in psychology, this one pits congenital, fundamentally genetic, explanations against explanations that rely on environmental determinism. Psychologists in the former camp think people are born with ingrained ideas about how hues are grouped. They believe the brain is preconditioned to pick out the six colours on a Rubik's cube whatever tongue it is taught to think in. The other camp, by contrast, thinks that the spectrum can be chopped into categories anywhere along its length. Moreover, they suspect that the language an individual learns from his parents is the main explanation for where that chopping takes place.

As with most nature-versus-nurture debates, compromise seems in order. Two papers published in the *Proceedings of the National Academy of Sciences* suggest where the middle ground lies.

Colourful thoughts

In the more recent of the two, which appeared this week, Terry Regier, of the University of Chicago, and his colleagues, picked at the question of preconditioned language categories. They used a grid displaying all possible hues rolled into a globe, with black at the north pole and white at the south. In this model, colours stick out from the sphere according to how sensitive the visual system is to them. Bright yellow, for instance, is easily noticed against a background of other colours, so the yellow part of the sphere bulges. Overall, the knobbly globe has exaggerated, smooth mountains with valleys in between.

If humans really are hardwired to home in on six focal colours, then all languages should assign words around those six. Dr Regier, however, tests a subtler concept. He thinks that useful languages should allot words in order to minimise the perceptual difference between colours of the same category, and maximise it between colours in different categories. Unlike national boundaries, linguistic boundaries should form only in the valleys of his colour globe, never over the hills.

Dr Regier therefore programmed his computer to find the best valley borders according to whether he told it to create three, four, five or six “countries” on the globe. Then, to judge whether people build languages around what their brains are best attuned to, he compared these theoretically best divisions with real-world dividing lines.

Since 1976, Paul Kay of the University of California, Berkeley, another of the paper's authors, has compiled a database of information about how 110 different languages assign colour adjectives to 330 different hues. When this database was compared with the theoretical optima, nature appeared important. The model closely fits some languages and points correctly to some details. For instance, three-colour language systems, which lump red and yellow together, generally exclude whitish yellow from that category—as does the model. But the results also explain where nurture gets its wiggle room. Real lexical boundaries tend to vary where Dr Regier's algorithm produced several options that were almost as good as each other.

In the second paper, published last week, Dr Regier and Dr Kay joined forces with Vicky Drivonikou, of the University of Surrey, in England, to address another way of investigating the question. This relies on the fact that brains have two hemispheres, but most language-processing is done in only one of them.

For reasons that lie deep in the evolutionary history of the vertebrates, the right hemisphere deals with sensory input from the left-hand side of the body, and vice versa. It is the left hemisphere, though, that deals with language—at least, it does in right-handed people. If language does affect colour-perception, then it is more likely to affect perceptions from the right visual field than the left.

In the first phase of the study, the researchers showed that their volunteers (Surrey university students) were slower to notice a target shade of blue when it flashed up against a blue background of a different hue than when it flashed up against a green background. Either nature or nurture (in a non-grue language) might explain that observation. But the researchers went further by presenting the test separately to the left and right visual fields of their volunteers. They found that they got the effect whichever visual field they presented the test to, but it was stronger when the presentation was to the right one (ie, to the left-hand, language-processing side of the brain), than to the left one.

That suggests both sides are correct. There is a fundamental—presumably congenital—distinction, as shown by the fact that the non-linguistic side of the brain distinguishes between blue and green. But there is also a language-mediated one, as shown by the linguistic side's greater response. The true test would be to do the experiment again—in Aberystwyth.

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Longevity

Nobel's greatest prize

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Is two years extra life

NO Nobel prize has yet been awarded for the invention of an elixir of life, but the prize itself seems to be one. That, at least, is the conclusion of Matthew Rablen and Andrew Oswald of the University of Warwick, in England. Dr Rablen and Dr Oswald have just published a study on the university's working-paper site which concludes that Nobel science laureates live significantly longer than those of their confrères who were nominated for a prize, but failed to receive one.

Strictly, this result applies only to the first half of the last century. The whole process of nominating potential prize winners and selecting actual ones is so shrouded in secrecy that Dr Rablen and Dr Oswald were able to work only with data from 1901 (the year the first prizes were awarded) to 1950. They further restricted their search to men (to avoid differences in life-span between the sexes), and eliminated those killed prematurely. That gave them 135 prize winners and 389 also-rans.

The theory they were testing was that status *per se*, rather than the trappings of status, such as wealth, act to prolong life. This idea was first promulgated by Sir Michael Marmot, of University College, London. Sir Michael studied the health of British civil servants and discovered, contrary to his and everyone else's expectations, that those at the top of the hierarchy—whom the stress of the job was expected to have affected adversely—were actually far healthier than the supposedly unstressed functionaries at the bottom of the heap.

Subsequent research has confirmed this result, and suggested it is nothing to do with the larger salaries of those at the top. But Dr Rablen and Dr Oswald thought it would be interesting to refine the observation still further, by studying individuals who were all, in a sense, at the top. By comparing people good enough to be considered for a Nobel, they could measure what the status of having one was worth.

Comparing winners and also-rans from within the same countries, to avoid yet another source of bias, Dr Rablen and Dr Oswald found that the winners lived, on average, two years longer than those who had merely been nominated. Exactly what causes this increased longevity is unclear. It is not the cash, though. The inflation-adjusted value of the prize has fluctuated over the years, so the two researchers were able to see if the purchasing power of the money was correlated with longevity. It was not.

With the hierarchically ordered individuals studied by Sir Michael and his successors, both medical records and experiments on animals suggest stress hormones are involved. It is, indeed, more stressful to be at the bottom than the top, even if being at the top involves making decisions on the fate of nations. The result Dr Rablen and Dr Oswald have come up with, though, suggests a positive effect associated with high status, rather than the absence of a negative effect, since unsuccessful nominees never know that they have been nominated.

A similar effect has been noted once before, in a different field. Research published a few years ago by Donald Redelmeier and Sheldon Singh, of Sunnybrook and Women's Hospital in Toronto, showed that Oscar-winning actors and actresses live 3.6 years longer than those who are nominated, but do not win. However, in that case the failed nominees do know that they have failed. And, curiously, Oscar-winning scriptwriters live 3.6 years less than do nominees. Perhaps writers, unlike actors and scientists, live in a world of inverted snobbery.

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Medical technology

Stirring things apart

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From The Economist print edition

A cheap and convenient way to conduct blood tests

ALBERT EINSTEIN worried not only about the big problems in physics but also about what may appear to be trivial. One example was his consideration of why tea leaves accumulate at the centre of the bottom of a stirred cup of tea rather than against the walls of the cup, as lesser mortals might assume they would. Trivial it may be, but never say that such blue-sky thinking is wasted. Nearly a century after Einstein's ponderings, a group of physicists led by Leslie Yeo of Monash University, in Australia, have applied the great man's explanation of tea leaves to design a quick and easy way to test blood for diseases and illegal drugs.

Stirring a cup of tea establishes two different patterns of fluid flow, as Einstein observed. The first is that caused directly by the spoon: the rotation of the tea around a vertical axis at the centre of the cup. If the tea were not in a vessel, this would indeed scatter the leaves away from the centre. But the walls and floor of the cup not only prevent the leaves from escaping, they also establish a second pattern of fluid flow. Friction between the tea and the cup slows the rotation, and the tea spirals down the walls of the cup and inwards at the base. Tea leaves are swept into the centre of the bottom of the vortex but are too heavy to be lifted by the rising tea at the centre. They therefore accumulate at the centre of the bottom of a stirred cup.

Dr Yeo and his colleagues have used this phenomenon to eliminate the need to centrifuge blood before it is analysed. Most of the medically interesting stuff in blood is in the plasma, but many of the tests employed on plasma require it to be separated from red blood cells. Centrifuges do this very effectively, but few doctors' surgeries are equipped with one, so samples have to be sent to outside laboratories, which consumes both time and money.

Dr Yeo's device, described in the latest issue of *Biomicrofluidics*, has no moving parts. The role of the teaspoon is played by a small, sharp metal point placed a few millimetres above the blood sample. A large voltage is applied to the needle and this, in turn, knocks electrons from the surrounding molecules of air. The resulting electrically charged molecules move rapidly away from one another, creating an “ionic wind” that is directed onto the blood sample and agitates it.

By placing the needle at an angle and to one side of the central axis—as one would place a spoon to stir a cup of tea—the researchers made the blood flow in the way that tea flows when stirred in a cup. And, as with tea, the heaviest components (red blood cells) accumulate at the centre of the bottom of the container. The whole job takes just over three minutes and works with smaller volumes of blood than are now typically needed for testing.

Indeed, Dr Yeo thinks the design could be used in testing kits only slightly bigger than credit cards. A retractable needle would draw the blood sample into the card, where its components would be separated and the plasma analysed in a matter of minutes. Different cards could be made to test for different diseases. They could also test for the presence of prohibited drugs or even for bacteria and viruses. It may not be as world-changing as relativity, but it should cause a small stir.

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Cancer biology

Cramping tumours

Jan 18th 2007
From The Economist print edition

An old observation about cancer cells may lead to a new treatment

CANCER cells manage their energy production in a most peculiar way. A healthy cell relies on its mitochondria (descendants of bacteria that took up residence in the single-celled ancestors of animals and plants about 2 billion years ago) to oxidise sugar molecules and release useful energy. Most cancer cells, however, use a less efficient mechanism called glycolysis to power themselves. They thus cut their mitochondria out of the loop.

That cancer cells often rely on glycolysis was discovered by Otto Warburg in 1930. But until recently the Warburg effect, as it has come to be known, was little more than a curiosity—and a contentious one at that. Now, it looks a lot more interesting, for Evangelos Michelakis and his colleagues at the University of Alberta, in Canada, are testing a drug called dichloroacetate that suppresses the Warburg effect and reactivates the mitochondria. The result shows why mitochondrial suppression is so important to tumours: when they are unsuppressed, the tumour they are in stops growing.

At first sight, this is all terribly paradoxical. Cancer cells multiply rapidly—and such multiplication requires a lot of energy. Normally, glycolysis is merely the prelude to energy production. It breaks glucose down into molecules called pyruvate that are fed to the mitochondria for processing. This breakdown yields some energy, but not much. However, it does not require oxygen—a substance that cancer cells are frequently deprived of, as tumours often fail to develop the blood vessels needed to supply it.

Cancer cells seem to adjust so well to glycolysis that even if blood vessels do grow into a tumour and the oxygen thus returns, they stick with it. From the cancer's point of view that is a very good choice, as one of the other jobs of the mitochondria is to kill a cell if it goes bad—a process known as apoptosis.

The role of dichloroacetate is to re-activate the mitochondria by stimulating an enzyme that feeds pyruvate into their energy-generating cycle. (The drug is already tested and approved for the treatment of certain mitochondrial diseases.) It seems this reactivation also allows the mitochondria to stimulate apoptosis.

At least, that is what Dr Michelakis thinks is going on. His results are certainly reminiscent of those obtained last year by Valeria Fantin and Philip Leder of Harvard Medical School. Dr Fantin and Dr Leder used a trick called RNA interference to modify glycolysis in the tumours of some specially bred laboratory mice.

If too much pyruvate is being made, the surplus is normally turned into lactic acid. (Athletes whose muscles demand more energy than their mitochondria can deliver suffer from a build-up of lactic acid as their glycolytic pathways go into overdrive. It is this build-up that causes cramp.) The RNA interference employed by Dr Fantin and Dr Leder stops the conversion of pyruvate into lactic acid, causing it to build up. Their hope was that, overwhelmed with pyruvate, the mitochondria would be forced to respond.

And respond they did. Apoptosis shot up in the treated animals. Dr Fantin and Dr Leder also observed a marked decline in tumour growth rates. The survival rate of animals went up, too. None of the members of an untreated control group survived the four-month period over which the experiment was conducted. By contrast, 80% of the treated animals survived.

RNA interference is the subject of eager investigation among pharmaceutical companies, but so far it has yet to yield a drug approved by the regulators. Dichloroacetate, by contrast, is already employed for other purposes. That does not mean it will work as an anti-cancer agent in the real world, of course. But it does give it a head start. And even if dichloroacetate itself does not work, Dr Michelakis's study points towards a new approach to stopping cancer in its tracks.

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Comet McNaught

An unexpected guest

Jan 18th 2007
From The Economist print edition

This is a picture of Comet McNaught, which was visible just after sunset in the northern hemisphere last week, and now, having swung around the sun, is displaying its charms in evening skies south of the equator. Unlike Hale-Bopp, the last comet to register on the public consciousness, Comet McNaught seems to have caught astronomers napping. It was first spotted on August 7th 2006 by Robert McNaught of the Siding Spring Observatory in Australia, but blossomed into brilliance only at the end of the first week of January. By January 14th it was reckoned the brightest comet for 40 years. Catch it if you can.

NASA

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About sponsorship

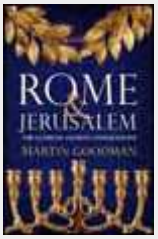
Judaism and the rise of Christianity

Spiritual and temporal

Jan 18th 2007
From The Economist print edition

An Oxford historian's attempt to compare two wildly differing cultures—Rome and Jerusalem—meets with only partial success

Rome and Jerusalem: The Clash of Ancient Civilizations
By Martin Goodman



Allen Lane; 656 pages; £25

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Bridgeman

IN THE Year of Our Lord 70, as it was later called, a place that had been associated for a thousand years with supreme holiness—the Temple in Jerusalem—underwent an orgy of destruction. Four years into a revolt by local Jews who were enraged by an imperial governor pilfering their Temple's funds, the Roman army burst into the courts of the sacred building and set it on fire, destroying it so thoroughly that disputes have raged ever since over where precisely it was.

The sacking of the Temple (pictured above in an 1867 painting by Francesco Hayez) was the biggest milestone, though not the only dramatic moment, in a series of military engagements between the Jews and Romans. These ranged from the conquests of Pompey, who about 130 years earlier had turned Judea into a vassal kingdom, to the final Jewish revolts that broke out at the start of the second century.

The consequences of these battles were felt all over the Roman empire. Having lost their locus of holiness, Jews were dispersed even more extensively than before across the Mediterranean world; some members of the widening Jewish diaspora embraced the Christian understanding of the Hebrew scriptures while others rejected it. As Christianity gained ground across the empire, and eventually became the state religion, disputes over how to read the scriptures (of which the Christian-Jewish argument was the bitterest, but certainly neither the first nor the last) were played out in a much larger arena.

To this extent, the subtitle of this impressive, scholarly book, “The Clash of Ancient Civilizations”, seems justified; it is true that Romans and Jews crossed swords in ways that had major consequences for world history. But in today's parlance, the idea of a “clash of civilisations” has taken on a fresh resonance, and that is presumably why the

subtitle was chosen. With its (mostly subconscious) allusions to the cold war and the uncertain relationship between Islam and the West, the world “civilisational” contest has come to be reserved for a titanic clash of values as well as arms. Much credit for this shift in meaning goes, of course, to Samuel Huntington, an American professor who saw the post-cold-war future as a stand-off between half a dozen geopolitical blocks, defined in religious as well as ethnic terms.

To elaborate a little, a “clash of civilisations” has come to imply not just sieges and bombardments, but also a systematic, long-term rivalry between alternative world views, metaphysical ideas and understandings of what it is to be human. In such a contest, each camp tries to galvanise not just its own supporters but also the bystanders who might be attracted by one view or other. For such a contest to be worth analysing at great length, there has to be a minimum of symmetry between the contenders: they have to have comparable aims and be competing in the same strategic arena. And on this count, it is not clear that Rome and Jerusalem fit the bill: Rome was a world power, with a genius for conquest, administration and construction. Jerusalem was a spiritual and cultural centre which served as capital of one small state (sometimes two) which had no aspiration to conquer distant lands or bend others to its will.

As Martin Goodman—an Oxford historian who has edited prestigious journals of Jewish and Roman studies—demonstrates quite well, some interesting comparisons can indeed be made between the ideologies that prevailed in Rome and Jerusalem. Both cities set great store by foundation stories that were believed to have unfolded many centuries earlier. But they had different ideas about later events.

Educated Romans liked to see their polity as a sort of secular democracy in which office-holders were responsible to the people and subject to frequent rotation. In practice, power rested with a hereditary plutocracy, but it was expected to earn its privileges through public service. In Jerusalem, of course, authority was theocratic: it could not be otherwise in a place of encounter between man and God.

As Mr Goodman shows, Roman sexual mores and family law were remarkably liberal, earthly and pragmatic; at the same time the way that law and custom entrenched the privileges of aristocrats over plebeians, free men over slaves, and men over women often sounds shocking to the modern ear. Jewish law was far more conservative in its attitude to sexual behaviour and nudity—and unyielding in its assumption that the highest source of legislation was divine.

Mediterranean mind-wrestling

All that is interesting as far as it goes, but ancient Rome and ancient Jerusalem were such different sorts of polity that questions arise about the legitimacy of the comparison. Surely the great cultural antinomy of ancient times was not between Rome and Jerusalem, but between Hellenism and Judaism? This, arguably, was the contrast that every great Mediterranean mind had to wrestle with for several centuries before and after the life of Jesus Christ.

As Mr Goodman lists the main features of Rome and Jerusalem (politics, ideology, law), he finds himself observing repeatedly that Romans and Jews reacted to Hellenism in different ways. The question is bound to arise when so much of Rome's art, literature and religion was derived from Hellenic sources. Indeed, part of what Rome's military power imposed on Judea was Hellenic culture. So in any discussion about Rome and Jerusalem, Athens shimmers in the background.

“What has Athens to do with Jerusalem?” That was the famous question posed by Tertullian, an early Christian thinker, and it presents a real and unavoidable dilemma which has never ceased to preoccupy the Western world's collective mind. To paraphrase the question, Tertullian asks what relationship exists between the world of revealed religion—in which God's self-manifestation is the ultimate source of knowledge—and the free intellectual inquiry of Greek philosophy.

One may conclude, like Tertullian, that Athens and Jerusalem are in the end separate worlds, separate ways of apprehending reality. But his inquiry is a real and pressing one, whereas it is not so clear that anybody needs to ask the question, “What (in a fundamental sense) does Jerusalem have to do with Rome?”

The latest public figure to wrestle with that dilemma was a man from Rome—Pope Benedict XVI, who in last year's controversial Regensburg address gave a closely argued presentation of the relationship between Hellenism, Judaism and revelation. He asserted that Greek rationalism and Abrahamic spirituality had fused, a couple of centuries before the coming of Christ, in a providential synthesis. This synthesis paved the way for Christian civilisation; the Islamic world, he implied, was the poorer for not having seen such an encounter between reason and revelation.

Mr Goodman would certainly regard that view as too optimistic: his book's final section presents Christianity—with its “usurpation” of the word Israel to mean a world-wide community of believers—as incorrigibly hostile to Judaism. In Mr Goodman's view, the children of Abraham's revelation are too bitterly divided among themselves to fuse seamlessly with anyone or anything. And there are many other grounds on which Pope Benedict might be challenged. Of all the sacred texts of Judaism and Christianity, some of the most arresting are works like Wisdom of Sirach, whose apocalyptic tone reflects the shock of the Jewish religious establishment at the encounter with Hellenic culture. A seamless fusion this was not.

But the main point is this: whether Jerusalem is being compared with Athens or any other centre of Hellenised culture, there is a great deal more for modern scholars to say about the elusive and all-important question of how Hellenism and Judaism interacted as value systems.

As for the comparison between Rome and Jerusalem, readers of Mr Goodman's sweeping compendium will learn many new things—but not all will agree that this particular comparison is fundamental enough to justify 600 pages.

Rome and Jerusalem: The Clash of Ancient Civilizations.
By Martin Goodman.
Allen Lane; 656 pages; £25

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About sponsorship

Paying for the old

Blast from the past

Jan 18th 2007
From The Economist print edition

A WRY series on British television called “Grumpy Old Men” features a cast of middle-aged celebrities who give vent to what they most dislike about modern life. Judging by his book, Robin Blackburn is made for the part, though viewers might scratch their heads over some of his pet spleens, such as “commodification” and “hyper-capitalist financialisation”.

As these rebarbative terms suggest, Mr Blackburn is a bit of an old leftie. This makes the theme of “Age Shock”—though not the book's hackneyed title—surprising. The left tends to play down worries about population ageing for fear that the right will exploit them to hack away at the welfare state. In contrast, this author does not underrate the demographic challenge, but sees it as an opportunity to suggest new ways to combat the market-based approaches he so reviles.

The old collectivist solution was “pay-as-you-go” financing of pensions: today's workers pay for today's pensioners while keeping their fingers crossed that a future generation of employees will stump up the taxes for their pensions. This works when there are many young and few old adults, but population ageing is making it less and less affordable by raising the ratio of pensioners to workers. This is why governments have been devaluing their pension promises, even though the soaring number of retirees will still push up the total bill.

Mr Blackburn does at least concede that the clock cannot be turned back and pay-as-you-go restored to its former prominence. There are limits to payroll taxes, and the public purse has other social calls upon it. As a result, he concurs with the British approach, which will increasingly confine public provision to a pension covering basic needs.

However, the author has no time for the other main strand of pension reform. As governments have salami-sliced future pension benefits, they have encouraged people to plug the gap through individual accounts. The book inveighs against the sinful ways of the businesses that handle retirement saving.

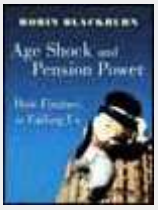
Mr Blackburn picks a soft target for his anathemas. It is hardly revelatory to point out that a lot has gone wrong with retirement saving, notably in Britain where there have been a number of financial scandals. The most important underlying problems are inadequate coverage and excessive charges that erode lifetime returns. The solution now being adopted in New Zealand and Britain is to combine privately owned accounts with cheap public arrangements to collect the savings directly from pay packets. Workers will be automatically enrolled into the arrangement but will retain a right to opt out.

Rather than pursuing this innovative and well-considered approach, the author advocates bolstering pensions from “social trust funds” financed by a “share levy” on companies. This is just a tax grab. Since the funds would lack clear individual property rights, they could give rise to far graver financial scandals than any that have occurred until now. Vulnerable to political interference, they would open a back door to public ownership of private companies. As the poor performance of nationalised industries suggests, a surer recipe for fouling up the economy could hardly be concocted.

The right way to tackle population ageing is for people to work longer and to save more. Reforms should encourage individuals to provide more for their retirement as they live longer. They should not resuscitate old socialist pipe-dreams about “decommodifying” market economies.

Age Shock: How Finance is Failing Us.
By Robin Blackburn.
Verso; 328 pages; $34.95 and £19.99

Age Shock: How Finance is Failing Us
By Robin Blackburn



Verso; 328 pages; $34.95 and £19.99

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Entrepreneurship in Shanghai

Mandarin mogul

Jan 18th 2007
From The Economist print edition

NO MATTER what you may be selling, your business in China would be enormous if the Chinese who are meant to buy your goods would only do so. This observation about the perils of doing business in China should be uppermost in the thoughts of every hopeful foreign executive whose plane touches down on the mainland today. Yet it was first made 70 years ago, by Carl Crow, perhaps the original “old China hand” and author of one of the most influential and amusing books on how to sell to the Chinese—his 1937 bestseller, “Four Hundred Million Customers”.

The lessons Crow drew from observing Western companies in China, first as a journalist and newspaper publisher and then as an advertising executive in Shanghai, remain relevant. Then as now, it is naive to assume that Chinese consumers will buy what you make just because it is cheap, and foolish to treat the vast country with its differences in income, climate and tastes as a single, giant market.

On reading Paul French's book, “Carl Crow”, however, it becomes clear that the Missouri-born entrepreneur's life is at least as instructive and engaging as his books. Arriving in Shanghai in 1911 as a 28-year-old rookie reporter, Crow had a lust for adventure. Unlike most of his peers, who lived a comfortable colonial existence in Shanghai's international settlement, Crow reported on floods up the Yangzi, negotiated the release of hostages from a Shandong warlord and slept in inns so grim he would stand his bed legs in kerosene to keep centipedes at bay. Most importantly, he worked hard to learn about the local culture and language, and soon came to understand and even appreciate how the Chinese did things—from the way businessmen preserved “face” during the toughest negotiation to the tricks beggars used to exaggerate their poverty and win more alms: one woman he knew rented a child. Whenever a local foible or tradition grabbed his interest, such as the country's idiosyncratic waterway laws, he would research it exhaustively.

All this led to jibes of “going native” from fellow Westerners. But Crow's inside knowledge and the respect he won from locals helped him build Carl Crow Inc into the country's biggest advertising agency—and, for a time, made him a rich man.

Crow coincided with enormous political and social ructions in China. He arrived in the final year of the Qing dynasty, when China's last emperors were overthrown. He met both Sun Yat-sen, the founder of the republic that followed, and Chiang Kai-shek, the Nationalist generalissimo who ruled China for much of the inter-war period. After a year in Tokyo, Crow gave early and frequent warning about the growing power and ambitions of the Japanese, from whose invading army he was eventually forced to flee Shanghai in 1937, losing the fortune he had made.

Mr French, co-founder of a mainland market-research firm and something of a China hand himself, deftly blends details about Crow's personal life, including observations about his house and servants and his fondness for curried prawns, into a wider historical context. Throughout, the reader learns about Chinese business, society and history. But the overriding impression is of the energy, indefatigable optimism and sheer adaptability of a likeable and pioneering American entrepreneur—all qualities that are still essential in China today.

Carl Crow—A Tough Old China Hand: The Life, Times, and Adventures of an American in Shanghai.
By Paul French.
Hong Kong University Press; 324 pages; $35

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New fiction

Little Hitler

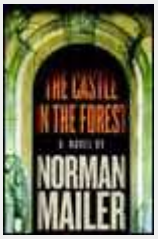
Jan 18th 2007
From The Economist print edition

SOME figures in history are so clearly defined that reinvention is ineffectual, if not impossible. On these grounds, any attempt to fictionalise Adolf Hitler should be anathema, yet he is the oblique subject of Norman Mailer's latest novel, his first in a decade.

How does America's foremost literary lion solve a problem like Adolf? By concentrating on the genealogy of the Hitlers and the trials and tribulations of “Adi's” parents. Most of “The Castle in the Forest” is dedicated to the bee-keeping habits and lusty philandering of his father, Alois, while Adolf lurks ominously in the background: a needy, ill-humoured child, harbouring an over-possessive love for his mother and a penchant for war games. Or he is less still, just a glint in his grandfather's eye (Adolf here is a product of “Second-Degree Incestuary”, a source of great interest for our narrator).

Mr Mailer's voice, always such a marked presence in his work, takes the form of a demon masquerading as an SS officer, acting on a compulsion to tell his story against the devil's will. Assuming the role of an omniscient spirit allows Mr Mailer a literary indemnity. His fictitious musings are made fact by the status of their infernal scribe, while their reportage is a reminder of Mr Mailer's own journalistic roots. “[It] certainly has to be most curious as a biography since it is as privileged as a novel,” he crows.

The Castle in the Forest
By Norman Mailer



Random House; 496 pages; $27.95.
Little, Brown; £17.99

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“The Castle in the Forest” is a gleeful hodgepodge of ideas, held together by this satanic conceit. Freudian prognoses (the young Adi's witnessing of the primal scene as the source of his father-hate) mingle with cod psychology (his “will of iron” is forged by his early home above a smithy). References to witness relocation programmes and terrorist cells give the book a modern twist.

Mr Mailer's style has grown more padded and voluminous over the years as his subject matter has taken him further away from what he knows, and the novel smacks of digression at times. His meticulous observations of family life can seem trite in comparison with the events soon to come. But just as often, these details compose a fascinating silhouette of a character that arguably shaped the 20th century more than any other. Drawing from Hitler's surroundings and context, Mr Mailer succeeds in re-humanising a man who has become a personification of evil. His Adi is more terrifying than any monster.

The Castle in the Forest.
By Norman Mailer.
Random House; 496 pages; $27.95.
Little, Brown; £17.99

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About sponsorship

The Duchess Anna Amalia library

Paper promises

Jan 18th 2007 | WEIMAR
From The Economist print edition

A grand reopening is planned for a rococo jewel that nearly burned to the ground

IF YOU walk down the sleepy streets of Weimar, past the Duchess Anna Amalia library, where Goethe, Germany's great poet and leader of the Enlightenment, was director for 35 years, you will see clouds of dust and hear loud banging. A massive restoration scheme is under way, preparing the 18th-century rococo jewel for a grand official reopening later this year, the 200th anniversary of the death of the woman who first came to Weimar in 1756 as the 16-year-old wife of the city's Duke Ernst August Constantin.

Replete with treasures, this former East German city was virtually a backwater until 2004 when a fire—the biggest library burning in Germany since the second world war—ravaged the magnificent rococo hall and the priceless book collection housed within it, and made headlines around the world.

Klassik Stiftung Weimar

Pour on water, pour on water

The fire damaged or destroyed 112,000 books, many of them first editions of Baroque and Enlightenment classics as well as Anna Amalia's collection of 700 rare musical manuscripts. (The blaze was caused by the building's faulty wiring, much of which was 70 years old. The city's fire department estimated that temperatures at the heart of the blaze reached as high as 1,000°C.)

These volumes represent just a fraction of the library's 1m books. But it is estimated that repairing or replacing them will cost nearly €70m ($90.6m) over the next ten years. Already, 40,000 burned and water-soaked volumes have been returned from the Zentrum für Bucherhaltung (centre for book maintenance) in Leipzig where they were placed in plastic bags and stacked in a large freezer. The books were then freeze-dried, a process that evaporates the ice into gas to stop further water damage or mildew.

In an odd twist, thousands of 19th-century and early 20th-century classics actually benefited from the fire. The 300,000 litres (66,000 gallons) of water that the firemen poured on the blaze helped to flush out the acid that had been used in the original papermaking process and which had previously been destroying the books. But not all were so fortunate: thousands of book covers are so warped that they cannot even be opened. Conservationists working in a new branch of the library still face the task of removing ash deposits between pages, repairing parchment volumes and vellum spines that split in the fierce heat—a painstaking process that involves weeks of work on each book.

That leaves more than 50,000 books (many in multi-volume editions) needing to be replaced altogether. These range from exquisite editions of Baroque literature that belonged to a Silesian nobleman who was the son of a renowned poet, Friedrich von Logau, to a slender volume entitled “Necessary and Useful Rules for Hunting and the Care of Grazing Animals”, dating back to 1623. So far Katja Lorenz, who heads the library's replacement team, has acquired more than 8,000 volumes—half by purchase and the rest as gifts.

Three-quarters of Ms Lorenz's work is at antiquarian book auctions, mostly in Germany, Switzerland and Austria. Although she often loses out to private collectors with deeper pockets, Ms Lorenz has also had her triumphs. One of her proudest finds is a volume of funeral orations for Duke August of Saxony and his wife, dating from 1588, complete with its original vellum binding and clasp, which she bought for a mere €845 on eBay last December. In 2005 she paid just €5,900 for a seven-volume Renaissance wonder, “L'Histoire de la Nature des Oiseaux” (“The Natural History of Birds”) by Pierre Belon du Mans, published in Paris in 1555. Interleaved with over 150 woodcut illustrations, the volume is one of the first of its kind to have been done from observation.

The Anna Amalia library is also swamped with unsolicited offers: “Sometimes I have the feeling that the whole of Germany wants to send their unread editions of Goethe and Schiller to Weimar,” says Michael Knoche, the library's scholarly director. But there are exciting moments too. Last year, the library took its pick from 140 first-edition Enlightenment classics donated by the family of the Duke of Sachsen-Meiningen. Looted by the Russian army in 1945, the books languished in a dusty library in Georgia before they were returned to the family in the mid-1990s.

Meanwhile, Fred Warren, the son of a former American GI, presented the Anna Amalia with Vinzenz Briemle's two rare illustrated volumes of travel writing after he discovered that the library's copies were destroyed in the fire. These follow journeys to Italy, Germany, Austria and the Holy Land and date from 1727. The books, which Mr Warren's father brought back to America as a German war souvenir in 1945, are among only ten surviving examples. More such gifts, please.

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Momofuku Ando

Jan 18th 2007
From The Economist print edition

Imaginechina

Momofuku Ando, inventor of instant noodles, died on January 5th, aged 96

FOR centuries men and women have turned to the east for the secret of life, health and happiness. But Momofuku Ando taught that there is no need to climb half-naked up a mountain peak, or meditate for hours on a prayer-mat, or knot one's legs round one's neck while intoning “Om” through the higher nasal passages. One should simply

> Peel off lid.
> Pour boiling water.
> Steep for three minutes.
> Stir well and serve.

Nothing was easier. Of course, the unenlightened could stumble sometimes, burning their tongues, or jabbing in a fork after only one minute of silent contemplation, which bent the prongs and sprayed the soup over the keyboard. But the patient disciple achieved fulfilment: mouthful upon mouthful of warming, strangely angular noodles, in flavours such as “Hearty Chicken” or “Shrimp Picante”.

Most devotees of Cup Noodle did not investigate the mystery further. Giddily grateful as they were to be relieved of cooking, it might have been electrical wire they were eating, or sauteed rubber bands. But some, after many portions, could make an unthinking mantra of the list of ingredients: Wheat Flour, Palm Oil (Tocopherols), Tapioca Starch, Salt, Dehydrated Vegetables (Cabbage, Green Onion, Carrot), Disodium Guanylate, Disodium Inosinate. And at the highest level one follower succeeded in straightening the noodles out, discovering in his cup eight strands 2mm in diameter and measuring 40cm (16 inches), evidently extruded with perfect uniformity, and cut into perfect lengths.

The cult was global. In 2005, 86 billion servings of instant noodles were eaten around the world. And all this began with a vision, as such things do. One cold night in 1957, walking home from his salt-making factory in Osaka, in Japan, Mr Ando saw white clouds of steam in the street, and a crowd of people gathering. They were waiting for noodles to be cooked to order in vats of boiling water, and were prepared to wait a long time. Why not make it easier? thought Mr Ando. And why not try to do it himself?

His life until then had been a bit of a mess. He had sold dress fabrics, following in the footsteps of the grandparents who had brought him up. He had sold engine-parts, prefabricated houses, magic-lantern projectors, socks. He had presided over a credit association, which had gone bust, and tried to launch a scholarship scheme for poor students, which had landed him in jail for tax evasion. But now the “steadily rising” clouds (or possibly, as in the cartoon on the homepage of his Instant Noodle Museum in Osaka, one fluffy white cloud with a kettle dangling from it) had shown him the Way.

Nights in the shed

The road was long. It took a year, working night and day in a shed in his back garden, to find the secret of bringing noodles back to life. Mr Ando cooked quantities, but had trouble getting the moisture out and keeping any flavouring in. He sprayed them with chicken soup from a watering can, and festooned the shed with them. The secret, picked up from his wife as she cooked vegetable tempura, was to flash-fry the cooked noodles in palm oil. This made them "magic".

In 1958 instant noodles went on the market, yellowish wormy bricks in cellophane bags, and were laughed at by fresh-noodle makers all over Japan. They were just a high-tech craze, costing six times as much as the fresh stuff; they would never catch on. By the end of the first year Mr Ando had sold 13m bags and had attracted a dozen competitors. He never looked back. In 1971 came noodles in heat-proof polystyrene cups, so that the hungry did not even need to get their bowls out of the cupboard. The Japanese voted instant noodles their most important 20th-century invention, Sony Walkmans notwithstanding. Mr Ando's firm, Nissin, became a $3 billion global enterprise.

But it was never just a company, and instant-noodlemaking never just an industry. The three sayings of Mr Ando became a philosophy of life:

> Peace will come when people have food.
> Eating wisely will enhance beauty and health.
> The creation of food will serve society.

Mr Ando practised what he preached. He ate *Chikin Ramen*, his original flavour of noodles, almost every day until he died. Though sceptics pointed out that they were loaded with fat, salt and monosodium glutamate, he looked bonny and spry. Seabeds across Asia were littered with plastic noodle cups; but that was not his fault.

His TV advertising, meanwhile, showed what instant noodles were really all about. When the world turned to eating them, barriers fell, children laughed and people loved each other. All liberating revolutions sprang from humanity's desire to gulp down steaming Cup Noodles whenever there was a chance. In 2006 a Japanese astronaut, on board the space shuttle *Discovery*, supped Mr Ando's noodles from a handy vacuum pack. He appeared on the TV ads weightless and smiling, his enlightenment complete.

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Overview

Jan 18th 2007
From The Economist print edition

Oil prices continued to wobble after Saudi Arabia said it saw no need to reduce its output to prop up the market. The benchmark price for a barrel of West Texas Intermediate came close to $50 on January 16th, before rebounding slightly.

In **Britain** consumer prices rose by 3% in the year to December, hitting the top end of the Bank of England's target range. Britain's jobless rate was unchanged at 5.5% in the three months to November.

In **America** industrial production grew by 0.4% in December, much faster than expected. Output in manufacturing rose by 0.7%, the largest monthly gain since June. The capacity-utilisation rate, a measure of the economy's slack, rose to 81.8%, which was 0.8 percentage points above its historical average.

Business confidence in **Germany** is improving. The ZEW index of economic sentiment, a measure of businessmen's cheer, sharply rose in January.

Led by strong growth in manufacturing, industrial production in **India** rose by 14.4% in the year to November.

Inflows of **foreign direct investment** rose for the third year running, increasing by 34% in 2006 to reach $1.2 trillion (see chart). The United States was the most popular destination, attracting $177 billion. Investments into China dropped a little, but remained high, at $70 billion.

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About sponsorship

Output, prices and jobs

Jan 18th 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2006†	2007†	latest	latest	year ago	2007†	rate‡, %
United States	+3.0 Q3	+2.0	+3.3	+2.2	+3.0 Dec	+2.0 Nov	+3.5	+2.0	4.5 Dec
Japan	+1.6 Q3	+0.8	+2.3	+1.9	+4.9 Nov	+0.3 Nov	−1.0	+0.4	4.0 Nov
China	+10.4 Q3	na	+10.5	+9.4	+14.9 Nov	+1.9 Nov	+1.3	+2.1§	9.8 2006
Britain	+2.9 Q3	+2.8	+2.6	+2.4	+0.8 Nov	+3.0 Dec**	+1.9	+2.2	5.5 Nov††
Canada	+2.5 Q3	+1.7	+2.8	+2.4	−2.4 Oct	+1.4 Nov	+2.0	+2.0	6.1 Dec
Euro area	+2.7 Q3	+2.0	+2.7	+2.0	+2.5 Nov	+1.9 Dec	+2.2	+2.1	7.6 Nov
Austria	+3.2 Q3	+3.6	+2.8	+2.3	+5.7 Oct	+1.5 Dec	+1.6	+1.6	4.7 Dec
Belgium	+3.1 Q3	+2.5	+2.8	+2.1	nil Nov	+1.6 Dec	+2.9	+1.8	11.9 Nov‡‡
France	+1.9 Q3	nil	+2.0	+2.0	−1.1 Nov	+1.5 Dec	+1.5	+1.4	8.7 Nov
Germany	+2.8 Q3	+2.6	+2.6	+1.6	+6.0 Nov	+1.4 Dec	+2.1	+2.1	9.8 Nov
Greece	+4.4 Q3	na	+4.1§	+3.5§	−1.8 Nov	+2.9 Dec	+3.6	+2.8§	8.3 Q3
Italy	+1.7 Q3	+1.1	+1.8	+1.2	+2.2 Nov	+1.9 Dec	+2.0	+1.9	6.8 Q3
Netherlands	+2.7 Q3	+2.8	+2.8	+2.3	+3.7 Nov	+1.1 Dec	+2.0	+1.7	5.2 Dec††
Spain	+3.8 Q3	+3.6	+3.6	+3.0	+4.1 Nov	+2.7 Dec	+3.7	+2.7	8.4 Nov
Czech Republic	+5.8 Q3	+5.6	+6.0	+4.8	+7.6 Nov	+1.7 Dec	+2.2	+3.3	7.7 Dec
Denmark	+3.2 Q3	+2.9	+3.3	+2.3	+7.9 Nov	+1.8 Dec	+2.2	+1.9	4.0 Nov
Hungary	+3.8 Q3	+4.2	+3.7	+2.4	+10.8 Nov	+6.5 Dec	+3.3	+5.9	7.5 Nov††
Norway	+2.6 Q3	+5.2	+2.5§	+2.3§	−5.8 Nov	+2.2 Dec	+1.8	+2.6§	3.1 Nov††
Poland	+5.8 Q3	na	+5.3	+4.7	+11.7 Nov	+1.4 Dec	+0.7	+2.5§	14.9 Dec‡‡
Russia	+6.5 Q3	na	+6.7	+6.5	+3.0 Nov	+9.1 Dec	+10.9	+9.2§	6.7 Nov‡‡
Sweden	+4.4 Q3	+4.1	+4.6	+3.3	+6.2 Nov	+1.6 Dec	+0.9	+1.9	4.3 Nov‡‡
Switzerland	+2.4 Q3	+1.5	+2.8	+2.0	+8.2 Q3	+0.6 Dec	+1.0	+1.0	3.3 Dec‡‡
Turkey	+3.4 Q3	na	+5.2	+4.0	+10.9 Nov	+9.7 Dec	+7.7	+8.6§	9.1 Q3‡‡
Australia	+2.2 Q3	+1.2	+2.5	+2.9	+0.9 Q3	+3.9 Q3	+3.0	+2.8	4.6 Dec
Hong Kong	+6.8 Q3	+14.8	+6.0	+5.0	−0.6 Q3	+2.2 Nov	+1.2	+2.5§	4.4 Dec††
India	+9.2 Q3	na	+8.3	+7.4	+14.4 Nov	+6.3 Nov	+5.3	+6.1§	7.6 2006
Indonesia	+5.5 Q3	na	+5.3	+5.8	−4.8 Oct	+6.6 Dec	+17.1	+6.6§	10.3 2005
Malaysia	+5.9 Q3	na	+5.5	+5.2	+7.2 Nov	+3.1 Dec	+3.5	+3.4§	3.1 Q3
Pakistan	+6.6 2006§§	na	+6.2§	+6.6§	+6.8 Sep	+8.9 Dec	+8.5	+7.0§	na
Singapore	+5.9 Q4	+7.6	+7.7	+5.0	+14.7 Nov	+0.5 Nov	+1.0	+1.0§	2.7 Q3
South Korea	+4.6 Q3	+4.4	+4.9	+4.2	+6.3 Nov	+2.1 Dec	+2.7	+2.3§	3.3 Dec
Taiwan	+5.0 Q3	na	+4.1	+3.9	+0.9 Nov	+0.7 Dec	+2.2	+1.5§	3.9 Nov
Thailand	+4.7 Q3	+6.0	+4.3	+4.3	+7.7 Nov	+3.5 Dec	+5.8	+3.6§	1.7 Oct
Argentina	+8.7 Q3	+10.8	+7.9	+6.3	+3.8 Nov	+9.8 Dec	+12.3	+9.8§	10.2 Q3‡‡
Brazil	+3.2 Q3	+1.4	+3.0	+3.3	+4.2 Nov	+3.1 Dec	+5.7	+3.7§	9.5 Nov‡‡
Chile	+2.9 Q3	−0.2	+4.7	+5.3	+3.2 Nov	+2.6 Dec	+3.7	+2.3§	6.6 Nov†††‡
Colombia	+7.7 Q3	+8.1	+5.1	+4.5	+17.4 Oct	+4.5 Dec	+4.9	+4.2§	11.0 Nov‡‡
Mexico	+4.6 Q3	+4.1	+4.4	+3.2	+4.8 Nov	+4.1 Dec	+3.3	+3.8§	3.6 Nov‡‡
Venezuela	+10.2 Q3	na	+7.8	+5.5	+12.2 Sep	+17.0 Dec	+14.3	+17.0§	10.1 Q3‡‡
Egypt	+5.9 Q1	na	+5.5	+5.4	+4.0 2005	+12.4 Dec	+3.1	+6.5§	10.9 Q2‡‡
Israel	+4.6 Q3	−1.1	+4.2	+4.2	+37.1 Oct	−0.1 Dec	+2.4	+1.7§	8.3 Q3
Saudi Arabia	+5.3 2006§	na	+5.3§	+5.4§	na	+2.7 Oct	+0.9	+2.0§	na
South Africa	+4.5 Q3	+4.7	+4.3	+4.2	+5.4 Nov	+5.4 Nov	+3.4	+5.6§	25.6 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+11.6 Q3	+11.7	+10.7§	+8.9§	+4.8 Nov	+5.1 Dec	+3.6	+3.8§	4.2 Oct
Finland	+5.8 Q3	+3.6	+4.5§	+2.7§	+5.4 Nov	+2.2 Dec	+1.0	+1.9§	7.5 Nov
Iceland	+0.8 Q3	+0.4	+3.7§	+0.7§	na	+6.9 Jan	+4.4	+5.4§	1.1 Nov‡‡
Ireland	+7.7 Q3	+10.8	+5.8§	+5.3§	−10.8 Nov	+4.4 Nov	+2.6	+3.4§	4.5 Dec
Latvia	+11.8 Q3	na	+10.8§	+8.0§	+0.7 Nov	+6.8 Dec	+7.0	+5.2§	6.8 Oct
Lithuania	+6.4 Q3	+5.3	+7.3§	+6.5§	na	+4.5 Dec	+3.0	+4.4§	5.7 Oct
Luxembourg	+5.4 Q3	+4.1	+5.5§	+4.3§	−0.4 Sep	+2.3 Dec	+2.5	+1.8§	4.6 Nov‡‡
New Zealand	+1.3 Q3	+1.0	+1.9§	+1.8§	−1.4 Q3	+2.6 Q4	+3.1	+3.0§	3.8 Q3
Peru	+6.9 Nov	na	+6.0	+5.4	+9.4 Oct	+1.1 Dec	+1.5	+2.2§	8.5 Nov‡‡
Philippines	+4.8 Q3	+1.3	+5.5	+5.3	−19.2 Oct	+4.3 Dec	+6.7	+5.1§	8.0 Q3‡‡
Portugal	+1.5 Q3	−0.6	+1.2§	+1.4§	+5.5 Nov	+2.5 Dec	+2.6	na	7.4 Q3‡‡
Slovakia	+9.8 Q3	na	+7.5§	+6.1§	+9.8 Nov	+4.2 Dec	+3.7	na	12.7 Oct
Slovenia	+5.6 Q3	na	+4.5§	+4.0§	+8.3 Nov	+2.8 Dec	+2.3	na	8.6 Nov‡‡

*% change on previous quarter, annual rate. †*The Economist* poll. ‡National definitions. §Economist Intelligence Unit estimate/forecast. **RPI inflation rate 4.4% in Dec. ††Latest three months. ‡‡Not seasonally adjusted. §§Year ending June.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Jan 18th 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Jan 9th	Jan 16th*	% change on one month	% change on one year
Dollar index				
All items	176.9	183.9	–0.7	+22.5
Food	150.1	156.3	+1.9	+18.0
Industrials				
All	211.6	219.6	–3.1	+26.9
Nfa†	147.7	151.9	+8.3	+6.0
Metals	246.5	256.5	–6.2	+35.6
Sterling index				
All items	138.2	142.2	–0.6	+9.9
Euro index				
All items	125.8	131.5	+1.1	+14.3
Gold				
$ per oz	609.10	624.60	+0.7	+11.8
West Texas Intermediate				
$ per barrel	55.57	51.28	–18.2	–22.7

*Provisional †Non-food agriculturals.

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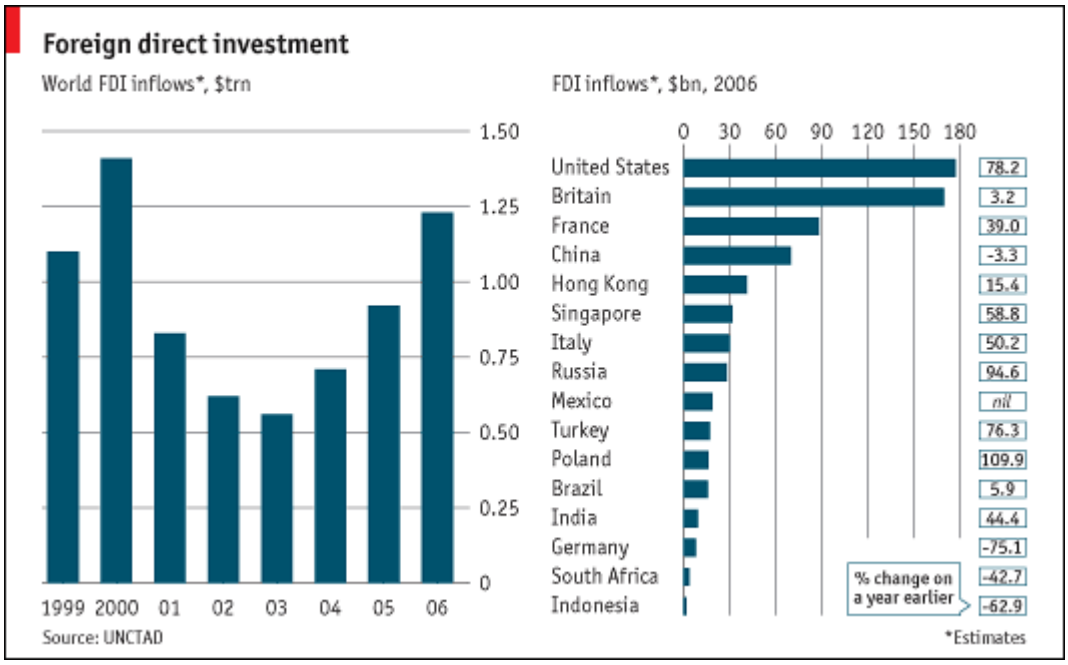
Foreign direct investment

Jan 18th 2007
From The Economist print edition



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About sponsorship

Trade, exchange rates, budget balances and interest rates

Jan 18th 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†	Currency units, per $ Jan 18th	Currency units, per $ year ago	Budget balance % of GDP 2007‡	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−837.2 Nov	−880.3 Q3	−6.3	–	–	−2.3	5.24	4.78
Japan	+79.6 Nov	+171.1 Nov	+3.8	121	115	−4.8	0.48	1.68
China	+177.5 Dec	+160.8 2005	+6.7	7.77	8.07	−1.9	2.80	3.10
Britain	−152.2 Nov	−69.7 Q3	−2.8	0.51	0.57	−2.7	5.52	4.89
Canada	+49.8 Nov	+28.9 Q3	+1.1	1.17	1.17	0.7	4.15	4.16
Euro area	−15.7 Nov	−26.7 Oct	−0.1	0.77	0.83	−1.7	3.75	na
Austria	−0.6 Oct	+12.2 Q3	+1.4	0.77	0.83	−1.4	3.75	4.02
Belgium	+15.5 Oct	+6.8 Sep	+2.2	0.77	0.83	0.1	3.80	4.03
France	−36.1 Nov	−43.0 Nov	−1.1	0.77	0.83	−2.5	3.75	4.03
Germany	+203.0 Nov	+121.5 Nov	+3.9	0.77	0.83	−1.7	3.75	3.99
Greece	−42.4 Oct	−27.9 Oct	−7.1†	0.77	0.83	−2.9	3.75	4.24
Italy	−27.7 Oct	−43.5 Oct	−1.8	0.77	0.83	−3.5	3.75	4.20
Netherlands	+39.4 Nov	+63.2 Q3	+7.8	0.77	0.83	0.6	3.75	4.01
Spain	−110.1 Oct	−103.9 Oct	−8.5	0.77	0.83	0.6	3.75	4.04
Czech Republic	+2.0 Nov	−5.2 Q3	−2.7	21.5	23.8	−4.0	2.57	3.80
Denmark	+6.9 Nov	+7.2 Nov	+2.2	5.76	6.17	3.0	3.91	3.97
Hungary	−2.8 Nov	−6.9 Q3	−5.9	196	208	−7.1	8.05	7.24
Norway	+57.3 Dec	+56.0 Q3	+17.6†	6.44	6.73	19.3	3.96	4.36
Poland	−4.1 Nov	−6.5 Nov	−2.3	3.01	3.19	−2.5	4.20	5.18
Russia	+140.8 Nov	+95.6 Q4	+7.3	26.5	28.3	5.9	11.00	6.26
Sweden	+19.7 Nov	+26.2 Q3	+6.4	7.02	7.71	2.4	3.14	3.87
Switzerland	+9.7 Nov	+105.9 Q3	+13.4	1.25	1.28	1.2	2.15	2.59
Turkey	−53.2 Nov	−33.7 Nov	−6.6	1.43	1.34	−2.8	19.60	19.36
Australia	−9.4 Nov	−39.5 Q3	−5.2	1.27	1.34	1.1	6.46	5.86
Hong Kong	−17.3 Nov	+19.2 Q3	+9.3	7.80	7.76	1.1	3.99	3.87
India	−48.8 Nov	−13.7 Q3	−2.2	44.2	44.3	−4.3	7.12	7.98
Indonesia	+38.5 Nov	+7.0 Q3	+1.4	9,108	9,500	−0.9	9.46	6.20§
Malaysia	+28.6 Nov	+22.2 Q3	+11.1	3.50	3.76	−4.1	3.73	5.37§
Pakistan	−12.9 Dec	−6.0 Q3	−5.1†	60.9	59.9	−4.6	10.36	6.50§
Singapore	+33.1 Dec	+39.0 Q3	+25.2	1.54	1.63	0.3	3.41	3.06
South Korea	+16.7 Dec	+6.2 Nov	nil	937	992	0.4	4.93	4.97
Taiwan	+21.3 Dec	+26.3 Q3	+5.0	32.8	32.1	−2.8	1.82	2.08
Thailand	+1.3 Nov	+2.1 Nov	nil	35.8	39.4	−1.2	5.25	4.97
Argentina	+12.0 Nov	+6.7 Q3	+1.6	3.08	3.05	1.4	10.19	na
Brazil	+46.1 Dec	+13.7 Nov	+0.3	2.14	2.32	−2.2	13.19	6.16§
Chile	+22.1 Dec	+5.2 Q3	+2.2	543	535	5.8	5.16	5.37§
Colombia	+0.3 Oct	−2.3 Q3	−2.1	2,225	2,272	−1.5	6.71	6.22§
Mexico	−5.9 Nov	−1.3 Q3	−1.1	10.9	10.6	−0.3	7.05	7.91
Venezuela	+36.8 Q3	+29.7 Q3	+10.1	4,135	2,585	−2.5	10.00	6.55§
Egypt	−11.1 Q2	+3.5 Q2	+1.1	5.70	5.74	−8.0	9.67	5.49§
Israel	−7.9 Dec	+6.7 Q3	+1.5	4.23	4.63	−2.9	4.60	5.14
Saudi Arabia	+125.6 2005	+90.0 2005	+25.7†	3.75	3.75	16.8	4.95	na
South Africa	−9.6 Nov	−13.5 Q3	−4.9	7.17	6.06	−2.0	9.35	7.94
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−3.1 Oct	−2.1 Nov	−11.1†	12.1	12.9	0.7	na	na
Finland	+11.7 Nov	+12.3 Nov	+4.0†	0.77	0.83	0.5	3.72	4.04
Iceland	−1.9 Nov	−3.9 Q3	−13.3†	70.2	61.8	2.1	15.02	na
Ireland	+35.9 Oct	−6.5 Q3	−4.8†	0.77	0.83	0.4	3.75	4.01
Latvia	−4.7 Nov	−3.9 Nov	−14.1†	0.54	0.58	−1.2	3.37	na
Lithuania	−5.0 Nov	−3.3 Nov	−9.5†	2.67	2.85	−0.5	3.78	na
Luxembourg	−5.5 Oct	+4.8 Q3	na	0.77	0.83	−0.9	3.75	na
New Zealand	−3.9 Nov	+6.1 Q3	−8.5†	1.45	1.46	4.1	6.70	5.88
Peru	+8.5 Nov	+1.8 Q3	+0.7	3.19	3.38	0.1	4.42	na
Philippines	−4.0 Oct	+4.4 Sep	+3.1	48.8	52.8	−0.8	5.63	na
Portugal	−23.1 Oct	−16.9 Oct	−7.9†	0.77	0.83	−3.7	3.75	4.16
Slovakia	−3.5 Nov	−5.4 Sep	−5.8†	27.1	31.1	−3.0	4.14	4.30
Slovenia	−2.0 Nov	−0.9 Oct	−2.1†	0.77	0.83	−0.9	na	na

*Merchandise trade only. †*The Economist* poll. ‡Economist Intelligence Unit forecast. §Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian

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Markets

Jan 18th 2007
From The Economist print edition

Markets

	Index Jan 17th	% change on one week	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
United States (DJIA)	12,577.2	+1.1	+17.4	+17.4
United States (S&P 500)	1,430.6	+1.1	+14.6	+14.6
United States (NAScomp)	2,479.4	+0.8	+12.4	+12.4
Japan (Nikkei 225)	17,261.4	+1.9	+7.1	+4.9
Japan (Topix)	1,706.8	+2.6	+3.5	+1.3
China (SSEA)	2,920.1	−1.8	+139.2	+148.3
China (SSEB, $ terms)	160.9	+13.0	+150.0	+159.5
Britain (FTSE 100)	6,204.5	+0.7	+10.4	+26.3
Canada (S&P TSX)	12,730.4	+2.2	+12.9	+12.3
Euro area (FTSE Euro 100)	1,289.7	+1.5	+18.4	+30.0
Euro area (DJ STOXX 50)	4,146.7	+1.4	+15.9	+27.2
Austria (ATX)	4,365.6	+1.4	+19.1	+30.7
Belgium (Bel 20)	4,464.9	+1.3	+25.8	+38.1
France (CAC 40)	5,561.8	+1.1	+18.0	+29.5
Germany (DAX)*	6,701.7	+2.1	+23.9	+36.0
Greece (Athex Comp)	4,615.5	+2.4	+26.0	+38.3
Italy (S&P/MIB)	41,749.0	+0.9	+16.9	+28.4
Netherlands (AEX)	505.3	+2.6	+15.7	+27.0
Spain (Madrid SE)	1,583.7	+1.5	+37.0	+50.4
Czech Republic (PX)	1,609.9	+2.8	+9.3	+25.1
Denmark (OMXCB)	434.5	+1.8	+18.1	+29.8
Hungary (BUX)	24,055.8	+3.6	+15.7	+26.7
Norway (OSEAX)	499.0	+3.4	+32.4	+39.2
Poland (WIG)	52,362.2	+6.3	+47.1	+59.4
Russia (RTS, $ terms)	1,810.6	+2.3	+48.6	+60.9
Sweden (Aff.Gen)	373.6	+3.7	+27.3	+44.3
Switzerland (SMI)	9,104.6	+2.7	+20.1	+27.0
Turkey (ISE)	39,218.1	+7.1	−1.4	−6.5
Australia (All Ord.)	5,626.1	+2.3	+19.5	+28.3
Hong Kong (Hang Seng)	20,064.6	+2.5	+34.9	+34.0
India (BSE)	14,131.3	+5.8	+50.4	+53.2
Indonesia (JSX)	1,758.5	+2.8	+51.2	+63.4
Malaysia (KLSE)	1,139.7	+2.4	+26.7	+36.7
Pakistan (KSE)	10,615.0	+2.3	+11.1	+9.1
Singapore (STI)	3,037.7	+2.6	+29.4	+39.9
South Korea (KOSPI)	1,379.5	+1.7	nil	+7.9
Taiwan (TWI)	7,834.0	+1.8	+19.6	+19.8
Thailand (SET)	651.5	+4.7	−8.7	+4.6
Argentina (MERV)	2,055.4	+0.6	+33.2	+30.9
Brazil (BSVP)	42,735.0	+0.9	+27.7	+39.7
Chile (IGPA)	12,609.8	+2.0	+37.0	+29.2
Colombia (IGBC)	10,853.4	+2.8	+14.1	+17.2
Mexico (IPC)	26,558.5	+2.6	+49.2	+45.1
Venezuela (IBC)	44,850.8	−15.9	+119.9	+37.5
Egypt (Hermes)	61,178.9	−0.4	+10.5	+11.3
Israel (TA-100)	943.2	+2.8	+13.9	+24.1
Saudi Arabia (Tadawul)	7,215.6	−4.6	−56.8	−56.8
South Africa (JSE AS)	24,980.4	+1.8	+38.0	+22.1
Europe (FTSEurofirst 300)	1,510.4	+2.2	+18.4	+30.0
World, dev'd (MSCI)	1,490.6	+1.7	+18.5	+18.5
Emerging markets (MSCI)	893.7	+3.1	+26.5	+26.5
World, all (MSCI)	368.8	+1.8	+19.1	+19.1
World bonds (Citigroup)	649.9	−0.1	+4.8	+4.8
EMBI+ (JPMorgan)	407.9	+0.3	+10.6	+10.6
Hedge funds (HFRX)	1,285.9	+1.0	+10.1	+10.1
Volatility, US (VIX)	10.6	11.5	12.1	(levels)
CDSs, Eur (iTRAXX)†	21.4	−2.8	−41.8	−36.2
CDSs, N Am (CDX)†	28.6	−4.1	−37.9	−37.9
Carbon trading (EU ETS) €	4.11	+9.3	−80.5	−78.6

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Mank Leumile-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

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Government bonds

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Buyers of government bonds had little to show for their investments last year in local-currency terms. European markets performed especially badly. But exchange-rate gains brightened the picture for some investors, who benefited as foreign currencies appreciated against the greenback. The total return in Sweden in 2006 was 1% in local currency but over 17% in dollar terms. Likewise, favourable currency effects helped dollar-based investors in South Korea and Australia. However, in some markets they were hurt by exchange-rate movements. South Africa managed a healthy domestic return of more than 5%, but a depreciating currency turned this into a decline of 3% in dollar terms.

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